82-1258

No.

In the
Supreme Court of the United States

October Term, 1982

BRAEMOOR ASSOCIATES, a joint venture, and LAMBERT BERE, JR., OWEN HULSE, JR., CHARLES M. BENNETT, GEORGE JOUSMA, and WILLIAM J. KAYE, individually and as joint ventures doing business as Braemoor Associates,

Petitioners,

vs.

FEDERAL DEPOSIT INSURANCE CORPORATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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January 25, 1982

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QUESTIONS PRESENTED

1. In these days of increasing court of appeals caseloads or at any time, can the court of appeals conduct what amounts to a trial de novo on law and facts ignoring the function of the district court judge and the record and using law not argued at the district court level and law not even argued at the court of appeals level or is such action so far a departure from the accepted and usual course of judicial proceedings as to cause reversal by the Supreme Court?

2. Does a court of appeals have the absolute discretion to apply law not argued below to the facts as some circuits hold, or can it only do so in exceptional circumstances as other circuits require?

PARTIES TO THE PROCEEDING

Only the parties listed in the case caption are parties to this proceeding. Other parties originally sued have previously been dismissed by the Federal Deposit Insurance Corporation.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1982

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The petitioners Braemoor Associates, Lambert Bere, Jr., Owen Hulse, Jr., Charles M. Bennett, George Jousma and William J. Kaye respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit entered in this proceeding on August 13, 1982 and amended on October 28, 1982.

OPINION BELOW

The first opinion of the Court of Appeals is reported at 686 F.2d 550. The amended decision of the Court of Appeals and the Opinion of the District Court are unpublished and are reproduced at pages 32 and 1 of the appendix respectively.

JURISDICTION

The judgment of the Court of Appeals was entered on August 13, 1982. The judgment of the Court of Appeals was amended on October 28, 1982 in response to a timely petition for rehearing which was denied on that date, and this petition for a writ of certiorari was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Illinois Revised Statutes (1981) Chapter 17, Section 37 states as follows:

> §37. Loans to officers and loans on and purchases of bank's own stock.
>
> (1) It shall not be lawful for a state bank to make any loan or extension of credit in excess of $10,000 at any one time outstanding each to its president, or to any of its vice-presidents or its salaried officers or employees or directors or to corporations or firms, controlled by them, or in the management of which any of them are actively engaged, unless such loan or extension of credit and the provisions for the repayment thereof shall have been first approved, by the board of directors; provided that indebtedness of $5,000 or less arising by reason of any general arrangement by which a bank makes payment to or on behalf of participants in a bank credit card plan,

check credit plan, interest bearing overdraft credit plan or similar open-end credit plan shall not be deemed an extension of credit for purposes of this Section; provided further that the provisions of Section 35.2 of this Act shall also be complied with to the extent, if any, that such provisions are applicable to such loan or extension of credit.

(2) It shall not be lawful for a state bank to make any loan or discount on the security of the shares of its own capital stock or preferred stock or on the security of its own debentures or evidences of debt which are either convertible into capital stock or are junior or subordinate in right of payment to deposit or other liabilities of the bank, nor to be the purchaser or holder of any such shares or securities, unless necessary to prevent loss upon a debt previously contracted in good faith; and stock or securities of the character aforesaid so purchased or acquired shall, within six months from the time of its purchase or acquisition, be sold or disposed of at public or private sale.

STATEMENT OF THE CASE

Defendant Braemoor Associates ("Braemoor") is a joint venture made up of seven individuals, with the five of those individuals who are currently living being defendants in this case. The Federal Deposit Insurance Corporation sued Braemoor and these individuals for collection of two loans it claimed it had bought from the State Bank of Clearing which was in receivership. Jurisdiction of that suit in the United States District Court was based on 12 U.S.C. §1819. After amendments to the complaint and stipulations, only two loans remained at issue in the case, namely a $60,000 and a $240,000 loan which the Federal Deposit Insurance Cor-

poration ("FDIC") claimed were still outstanding and owing.

Braemoor Associates had as its purpose the purchase of real estate in Illinois for investment and resale. Braemoor financed its property acquisitions and improvements for the years prior to sale which were usually loss years by (1) borrowing on the value of the real estate, (2) the willingness of a contractor Seneca Petroleum Corporation to extend credit to Braemoor for in excess of $400,000 for improvements (Stipulation attached as Exhibit A to Pretrial Order ("Stip.") Par. 14.1, transcript p. 133-144)(3) the borrowing power of individual joint venturers who were wealthy, and (4) sales of real estate which eventually brought in money to cover all expenses and to give profits with said money coming from contracts of sale which were generally oral with numerous purchasers. The individual joint venturers were not told where they should go to borrow money. Many joint venturers were old customers of the State Bank of Clearing and they had previously borrowed money from that bank. Paul Bere, a joint venturer, was then president of that bank. Certain joint venturers borrowed over $500,000 from that bank which they then lent to Braemoor. Every single penny of those loans has been paid back to the State Bank of Clearing and those loans are not the subject of this lawsuit. Braemoor also borrowed over $750,000 from the Chicago City Bank which was a bank that was not related to the State Bank of Clearing. Those loans are in no way at issue in this case.

The State Bank of Clearing had a favored relationship with a man named Ringbloom and with 6 entities controlled by him and with officers of those entities. Ringbloom was a contractor and a real estate developer. Ring-

bloom and his companies were permitted to have huge overdrafts in their checking accounts at the State Bank of Clearing. Checks for Ringbloom and his entities would clear without there being funds in their checking accounts to pay those checks. Overdrafts on the checking accounts of $10,000 were common and overdrafts of as much as $71,000 occurred in those accounts. Ringbloom, his entities and his officers had millions of dollars of loans with the State Bank of Clearing. Examples of these loans and of overdraft balances are contained on Exhibits B and C of the Stipulation. In fact, when the State Bank of Clearing was closed, Ringbloom and related entities had loans and overdrafts that were stated by the FDIC to total $4,822.455.16. (Stip. Par. 3.5.2).

The facts now stated relate to the $60,000 loan which is one of the two loans that are the subject of the suit. Ringbloom approached Paul Bere wanting to purchase from Braemoor land on which to build condominiums. The sales price was $400,000 and the first payment on that price amounting to $60,000 was made in September of 1971. (Stip. par. 36.1) Although at the trial Ringbloom did not recall whether he had a payment schedule, joint venturer Hulse recalled that the next $60,000 payment was due in January of 1972. (Tr. p. 107, 106). To make that payment, Ringbloom went to the State Bank of Clearing and borrowed the $60,000 in a loan that was collateralized by stock which was stated on the loan minutes of the State Bank of Clearing to be worth $285,000. (Tr. p. 56, Stip. par 26). That loan was a six-month loan and the FDIC is trying to collect that loan from Braemoor and its members though they did not borrow that money and are not a part of Ringbloom's entities. The reason for the FDIC trying to collect from Braemoor

is that the loan proceeds were used to purchase property from Braemoor. As the six-month loan maturity was expiring, Ringbloom paid off the $60,000 loan by paying it from $800,000 of loans that he got for a 10-day period from another bank. Those loans were in turn paid off with an $800,000 loan that Ringbloom entities got from the State Bank of Clearing. (Stip. par. 29.1-29.4). The loan ledger at the State Bank of Clearing shows the $60,000 loan as paid. (Stip. par. 26.5) That loan had been approved by the Board of Directors of the State Bank of Clearing. (Stip. par. 26.4). At the time Braemoor got the $60,000 from Ringbloom on Ringbloom's purchase of land on which condominium units were built, Braemoor was not pressed for money and in fact could easily have gotten $60,000 or more from the Chicago City Bank where it had paid down one of its loans by $175,000 and where joint venturer Hulse's company had 1.2 million dollars in short term deposits. (Tr. p. 145, 134).

It is to be noted that Braemoor had no ownership interest in Ringbloom's entities and Ringbloom had no ownership interest in Braemoor.

The $240,000 loan will now be discussed. In July of 1972 Ringbloom approached Paul Bere and made an offer to purchase several 20-acre tracts of land at $240,000 per tract from Braemoor and he purchased the first tract for $240,000 in that month. (Tr. p. 148-149). Unknown to defendants in this lawsuit, the $240,000 came from a blank note that joint venturer Lambert Bere had left with his brother Paul Bere for family business six months to a year earlier which Paul Bere filled in for $417,000 and presented to the Board of the State Bank of Clearing which approved the loan. The $417,000 passed to Ringbloom without Lambert sign-

ing any checks because Paul used bank debit memos. Ringbloom used the entire $417,000 with $240,000 of that sum going for the purchase of a 20-acre parcel of real estate from Braemoor. That note was filled in and the $417,000 loan was obtained on the same day that Paul Bere got Ringbloom's entities $800,000 in 10-day loans from another bank which means Ringbloom's entities got $1,217,000 on loan transactions on that day alone through Paul Bere. (Stip. par. 29.1, 38). Within 21 days the $417,000-loan on the filled-in note was fully paid from proceeds of $780,000 in other loans that the Ringbloom entities got from the State Bank of Clearing. (Stip. par. 41-42.1). The loan ledger of the State Bank of Clearing states that the $417,000 loan has been paid. (Stip. par. 38.6). The FDIC is seeking to collect $240,000 of the $417,000 loan that *has been paid* from other loans Ringbloom obtained because Ringbloom used the $240,000 to purchase a 20-acre parcel from Braemoor, claiming that Paul Bere was involved on too many sides of the transaction. Added to this is the fact that Paul Bere was a secret partner of Ringbloom's in that purchase at the time he recommended that Braemoor sell the land to Ringbloom. (Tr. p. 147, 153). At the time that Braemoor got the $240,000 for the sale of the land, it was under no pressure from a corporate creditor to whom it paid that money after receiving it. (Tr. p. 134). That creditor had an excellent cash position at that time. (Tr. p. 134).

The trial of the case proceeded with a 45-page stipulation of facts plus the testimony of about 11 witnesses. After plaintiff rested, defendants moved for judgment under Rule 41(b) of the Federal Rules of Civil Procedure. The trial stopped, arguments were heard and a briefing schedule was set up. The District Court judge

then wrote a 19-page opinion dismissing the case and in that opinion the judge found that the two loans in question were made for the purchase of property for Ringbloom rather than as a device for financing Braemoor. He further found that the testimony of defendants was credible and that they had no actual or constructive knowledge of these two loan transactions or of Paul Bere's actions with regard to those loans for Ringbloom and further that defendants had not expressly or impliedly delegated to Paul the task of financing any purchaser purchasing land from Braemoor. The judge also found that defendants had sufficient sources of credit other than the State Bank of Clearing to meet their obligations as they became due. (Findings of Fact paragraphs 62-71 in the district Court Opinion).

The FDIC then appealed to the Seventh Circuit which reversed the District Court. That opinion noted that there was no per se prohibition in Illinois against banks loaning their officers money or lending money to entities wherein an officer had any management responsibilities. However, the Court of Appeals referred to a statute never argued by any party at any level which said officers could not approve such loans if they were over $10,000, but rather such loans had to be approved by the board of directors of the bank. The Appeals Court said that the loans were really not for the purpose of aiding a purchaser of real estate, but instead were actually loans to Braemoor and since such loans had not been approved by the bank board of directors they were considered to be fraudulently obtained and that fraud in not following the statute would be imputed to Braemoor and its members. However, contrary to that Court of

Appeals decision the parties had entered into a stipulation that was uncontradicted that stated that the loans had indeed both been approved by the bank's board of directors. A motion for rehearing was timely filed based on that fact and other claimed errors as to fact and law and as to the functions assumed by the Court of Appeals.

The Court of Appeals then amended its decision. It changed numerous facts. It still centered around the same statute, but this time it said that it was implicit in the terms of that statute that any conflict of interest had to be disclosed to the bank board when it considered the loans. It cited no decision supporting that implicit requirement. It still considered the loans to really be loans to Braemoor and stated that the loans did not involve financing any purchaser's of Braemoor real estate, but rather on page 11 it held the loans were for a street and sewer system on property owned by Braemoor. Since Paul Bere had not disclosed his conflict of interest to the bank board as to a relationship as a joint venturer, it said the loan had been obtained by fraud which would be imputed to Braemoor and its members. The Findings of Fact of the Court of Appeals in both opinions differed greatly from the Findings of Fact of the District Court. The Court of Appeals did not find that the Findings of Fact of the District Court were clearly erroneous.

REASONS FOR GRANTING THE WRIT

I. THE DECISION BELOW REPRESENTS A DECISION OF FACTS *DE NOVO* AS WELL AS A DECISION BASED ON LAW NOT ARGUED IN THE DISTRICT COURT AND LAW NOT ARGUED IN THE COURT OF APPEALS SO AS TO DISPLACE ENTIRELY THE FUNCTION OF THE DISTRICT COURT IN A MANNER WHICH HAS SO FAR DEPARTED FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS AS TO CALL FOR THE EXERCISE OF THIS COURT'S POWER OF SUPERVISION AND THIS IS ESPECIALLY TRUE BECAUSE IT ENCOURAGES THE FLOOD OF APPEALS TO THE COURT OF APPEALS FOR A TRIAL *DE NOVO*.

The Court of Appeals was grossly indifferent to the facts in the record of the District Court and its crucial "facts" in its opinion were not facts. This can most easily be demonstrated regarding the cornerstone fact of its first opinion. It held that fraud was attributed to the defendants due to the fact that the two loans involved had not been approved by the Board of Directors of the State Bank of Clearing as required by Illinois law. Diametrically opposite to this "fact" was the written stipulation of fact by the parties that in paragraph 55 clearly stated that such loans had in fact been approved by the Board of Directors of the State Bank of Clearing. Had it not been for that "fact", defendants would have had no liability under the reasoning of the first decision of the Court of Appeals and the District Court would not have been reversed. There were numerous "facts" stated in that first decision that were not facts in the

record. The petition for rehearing brought out such obvious errors to the Court of Appeals that it had to amend its decision to correct some of its errors as to facts. But in doing so, it adapted "facts" to bolster its legal theory that were not facts in the record and created a trial *de novo* on the facts absent the presence of witnesses and with blindness toward a 45-page written stipulation of facts contained in the pretrial order.

This Court has held that "It is not enough that we (the Supreme Court or an appellate court) might give the facts another construction, resolve the ambiguities differently, and find a more sinister cast to actions which the district court apparently deemed innocent. We are not given those choices because our mandate is not to set aside findings of fact 'unless clearly erroneous'." *United States* v. *Realty Board,* 339 U.S. 485 at 495-6 (1950). The Court of Appeals in the case presently before this Court even went beyond that restriction and "facts" that were truely nonexistent were used which went to the heart of its amended decision.

The amended decision continued to rely on the following Illinois statute which had never been cited by any party at the district court level and had never been cited by any party at the appeals court level:

> "It shall not be lawful for a state bank to make any loan or extension of credit in excess of $10,000 at any one time outstanding each to its president or to any of its vice-presidents or its salaried officers or employees or directors or to corporations or firms controlled by them or in the management of which any of them are actively engaged, unless such loan or extension of credit and the provisions for the repayment thereof shall have been first approved, by

> the board of directors". (Ill. Rev. Stat., 1981, ch. 17 § 347(1))

The amended decision stated that this language implicitly required the officers to disclose any conflict of interest in a loan and if that conflict of interest was not disclosed, the loan was fraudulently procured. The statute does not say that and there are no cases in the annotation of that statute which state that "implicit" requirement. Further, that statute causes no liability to defendants under the true facts of the case. The Appeals Court treats the loans to the Ringbloom entities so Ringbloom could purchase property from Braemoor as involving the "laundering" of money which in "fact" constituted loans to Braemoor Associates. The Appeals Court specifically stated at page 557 of the published opinion in 686 F.2d 550 and repeated in the amended opinion the following language: "The loans in issue were not for the purchase of any properties; they were for a street and a sewer system on property already owned by Braemoor". Thus, the Court of Appeals is saying that the Illinois statute applies because the loans are loans to Braemoor and not loans to Ringbloom for him and his entities to purchase property from Braemoor. In finding of fact 69, the District Court found the opposite was true, namely that "The loan transactions at issue were made for the purchase of property (by Ringbloom) rather than as a device for the purpose of financing the Braemoor partnership." The record backs the District Court finding rather than the Court of Appeals fiction. In paragraph 36.1 of the stipulation of facts that is Exhibit A to the Final Pretrial Order in the District Court the parties stipulated that the $60,000 involved was a payment by Western to Braemoor Associates with

respect to the purchase of the Condo property upon which it (Western, which is a Ringbloom entity) later built 88 condominium units. And as to the $240,000, Ringbloom testified he used it in July of 1972 to purchase 20 acres of land from Braemoor. (Tr. p. 148-9) Thus, the District Court's finding is based on fact and the loans were to Ringbloom and his entities, rather than being a loan to Braemoor, and the Illinois Banking Statute intended to apply because the Court of Appeals thought of it as a loan to Braemoor does not even apply to this case. Furthermore, these loans have been paid as shown in the Statement of the Case and no one has any liability for these loans, a fact ignored by the Court of Appeals.

The Court of Appeals also tried to make it appear that Braemoor forced these loan transactions because it needed a source of money to pay its bills. That is contrary to finding of fact 71 by the District Court which held that, "At the time of the transactions at issue, the defendants, both in their individual capacities and as a partnership, had sufficient sources of credit other than the State Bank of Clearing to meet their obligations as they became due." For instance, Braemoor could have easily obtained money from the Chicago City Bank where its loan of $500,000 had only $375,000 outstanding, according to Hulse, whose company was that bank's large depositor with $1,200,000 in 30-day CD's at that bank. (Transcript p. 145, 134).

It is also noted that the District Court judge who saw the witnesses as they gave their testimony found at finding of fact paragraph 62 that "the court finds the testimony of all of the defendants is credible". That judge also found at findings of fact 63 through 70 that the

defendants did not participate in the loan transactions, did not have express or constructive knowledge of what occurred, and did not expressly or impliedly delegate to Paul Bere to ararnge financing to Ringbloom or his entities for purchases from Braemoor. The record also is clear throughout that Braemoor was not in the ordinary course of business getting financing for its purchasers. The testimony and stipulation support the findings of the District Court. The Appellate Court did not find these findings clearly erroneous. Instead, it substituted its own "off-the-wall" findings of fact, and law that no one had ever argued at any level, and rendered a decision that was a *de novo* decision and thus so far departed from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's power of supervision.

It is also noted that the banking law applied to the case was applied only on the appeals court's own motion, and as Judge Learned Hand stated, "It is only an 'egregious kind of error' (that) we may consider on our own motion". *Scott* v. *Central Commercial Co.,* 272 F.2d 781 at 782-3 (2nd Cir., 1959). Such a situation is not involved in this case.

The Justices of this Court have been making pronouncements publicly as to ways to cope with the rising case loads of the federal court system. Getting the trial bar back to basic requirements of trial in the District Court is a clear way to help the situation. It should be known that a case brought in the United States District Court should be fully prepared on the facts and the law if it is taken to trial and that the United States Court of Appeals are not going to be "a second-guess heaven". This Court's power of supervision should be

exercised to enforce this point as well as to give the due respect to the district court judges who deal with arguments before them and who have the fact finding power.

II. THE DECISION BELOW CONFLICTS WITH DECISIONS OF OTHER CIRCUITS AS TO THE EXERCISE OF DISCRETION BY APPELLATE COURTS TO CONSIDER MATTERS NOT CONSIDERED BY THE DISTRICT COURT.

This reason goes beyond the *de novo* fact and law trial discussed above and refers to the Seventh Circuit applying for the first time a banking statute never referred to in the District Court or even referred to by the parties in the appeals court. In *Singleton* v. *Wulff*, 428 U.S. 106 at 121 (1976), this Court stated, "The matter of what questions may be taken up and resolved for the first time on appeal is left primarily to the discretion of the courts of appeals, to be exercised on the facts of individual cases. We announce no general rule. Certainly there are circumstances in which a federal appellate court is justified in resolving an issue not passed on below, as where the proper resolution is beyond any doubt, or where 'injustice might otherwise result.'" Most courts of appeals hold after that decision that they will consider something not raised in the district court only under extraordinary circumstances. *Journey* v. *Vitek*, 685 F.2d 239 at 243 (8th Cir. 1982), *Needleman* v. *Bohlen*, 602 F.2d 1 at 4 (1st Cir., 1979). However, the ninth circuit holds that *any* pure question of law that does not cause the parties to develop new or different facts can be raised in the court of appeals for the first time without limitation. *Commodity Future Trading Commission* v. *Co. Petro Marketing Group, Inc.*, 680 F.2d 573 at 581 (9th Cir. 1982). These positions are quite different.

Because there are no extraordinary circumstances in the case now before this Court, the Seventh Circuit had to be adopting the Ninth Circuit rational which freely permits raising new law issues for the first time in the court of appeals, based on the fact situation in the District Court, although the Seventh Circuit mangled the fact situation in the District Court. It is maintained that the Ninth Circuit position as adopted here is too broad for it opens the courts of appeals to liberal second guessing on new legal theories at the appeals levels whereas counsel really should have the obligation to fully express their reliance on points of law at the district court level except in extraordinary circumstances which certainly do not exist in the case currently before this Court. That conflict between the circuits should be resolved.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgments and opinions of the Seventh Circuit as amended.

Respectfully submitted,

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January 25, 1983

APPENDIX

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

FEDERAL DEPOSIT INSURANCE CORPORATION, Plaintiff,	)	NO. 76 C 3295
vs.	)	
BRAEMOOR ASSOCIATES, a joint venture, et al., Defendants.	)	Before the Honorable Nicholas J. Bua, Judge United States District Court

O R D E R

The matter before the court arises out of an action brought by the plaintiff, the Federal Deposit Insurance Corporation, against the defendants, Braemoor Associates, Lambert Bere, Jr., Owen Hulse, Jr., Charles M. Bennett, George Jousma and William J. Kaye, seeking the recovery of damages under theories of breach of trust, conspiracy, and unjust enrichment. The jurisdiction of the court is founded upon Title 12 U.S.C. § 1819. The matter at bar was tried by the court. At the close of the plaintiff's case, the defendants moved, pursuant to Rule 41(b), Fed. R. Civ. P., for involuntary dismissal of the claim. This court, after having reviewed the evidence presented at trial and the arguments of the parties, believes that dismissal of the plaintiff's claims is warranted. For this reason, the plaintiff's action is dismissed. In conjunction with this ruling, the court makes the following findings of fact and conclusions of law.

FINDINGS OF FACT

For brevity, the following persons and entities will be referred to herein as follows: Paul R. Bere ("Paul"); Lambert Bere, Jr. ("Lambert"); Owen Hulse, Jr. ("Hulse"); Charles M. Bennett ("Bennett"); William J. Kaye ("Kaye"); Allan Gustafson ("Gustafson"); David Mayes ("Mayes"); LaSalle National Bank of Chicago as Trustee under Trust No. 24786 ("LaSalle LT 24786"); Chicago City Bank and Trust Company of Chicago, individually and as Trustee under Trust Nos. 8825 and 8972 ("Chicago City Bank LT 8825" and "Chicago City Bank LT 8972", respectively); Seneca Petroleum Company ("Seneca"); Kenneth Ringbloom ("Ringbloom"); and Western Land Planning Company ("Western").

1. At all relevant times herein until his death on July 26, 1974, Paul was President, a Director and the Chairman of the Board of Directors of the State Bank of Clearing (the "Bank"), an Illinois banking corporation located at 5235 West 63rd Street, Chicago, Illinois. Lambert was a Director of the Bank from and after January, 1973. He began working at the Bank as a vice-president in August, 1974, was formally elected a vice-president by the Board of Directors in January, 1975, and continued to serve as vice-president until the Bank closed.

2. On July 12, 1975, the Illinois Commissioner of Banks and Trust Companies took possession and control of the State Bank of Clearing, its assets and affairs, and appointed the FIDC as Receiver thereof. A Complaint for Dissolution of the Bank was filed in the Circuit Court of Cook County, Illinois and was assigned Case No. 75 CH 4407. Pursuant to statutory authorization

and the approval of the Circuit Court of Cook County, the Receiver transferred certain of the assets owned by the Bank, including those at issue herein, to the FDIC in its corporate capacity.

3. At the time of the transactions in issue:

(a) Paul and Bennett were partners in the BEB partnership and were co-owners of property on Wise Road in Schaumburg, Illinois.

(b) Paul and Bennett were financially interested in Universal Wood Products.

(c) Paul, Bennett, Lambert and Kaye were co-investors in property referred to as the Roberts Road property.

(d) Paul, Lambert and Bennett jointly owned the Cornell Farm.

(e) Paul and Bennett each owned a 1/8th interest in the Briarcliff Apartments.

(f) Paul was a limited partner in Shore Heights Village Apartments, of which Ringbloom was one of the general partners and Western (100% owned by Ringbloom) was another limited partner.

(g) Paul and Ringbloom were partners in Ken Enterprises.

(h) Paul, Lambert, George Jousma and Richard Jousma were partners in View Enterprises and were jointly liable to Sam Pancotto for a $300,000 loan.

(i) Paul and Hulse were joint purchasers of certain property in Carol Stream, Illinois.

(j) Hulse, Lambert and View Enterprises [see (h) above] were co-lenders, at Paul's request, to Western Land Acquisition Company, a company owned by Ringbloom.

4. From time to time, Kaye, Bennett, Richard Jousma, George Jousma and Lambert, at Paul's request, signed promissory notes in blank as to date and amount, and left such notes in Paul's possession.

5. On December 31, 1968, Gustafson, Mayes, Kaye and Lambert as purchasers, and LaSalle LT 24786 as seller, executed an Agreement for Deed, for the purchase of 146 acres in DuPage County referred to as the "Braemoor Farm" or "the Farm". The Agreement for Deed required the purchasers to pay a total purchase price of $718,000 in installments, including a down-payment of $100,000 and installments of $100,000 each on the first day of October of 1970 through 1975, plus interest of 6-3/4% on the unpaid principal balance.

6. In April, 1969, Mayes, as purchaser, executed a Contract for the purchase of approximately 12 acres of property generally referred to as the Condominium or "Condo" property for $74,500.

7. On July 21, 1969, Mayes and Gustafson as "Developers" entered into an Annexation Agreement with the Village of Burr Ridge with respect to the Farm, the Condominium property and additional land referred to as the Braemoor Estates property.

8. Paragraphs 7A and 9 of the Annexation Agreement required the Developers to furnish a water system, including a 250,000 gallon water storage tank, for the property and convey the water system to the Village, build two Olympic size swimming pools and a recreational building on the property, and donate 8 lots to the Village.

9. Between April 22, 1969 and May 19, 1970, Paul approved and caused the Bank to make loans totalling $399,000 on notes signed by Mayes, Kaye, Richard Jousma and Gustafson. The loan proceeds were used to pay in part for the Farm, Condominium and Braemoor Estates properties. All of these loans have been repaid.

10. On June 30, 1970, Hulse, Bennett, Kaye, Richard Jousma, Lambert and Paul executed the Braemoor Associates Joint Venture Agreement ("Joint Venture Agreement"). Richard Jousma signed the Joint Venture Agreement on behalf of himself and George Jousma, each of whom had a one-twelfth (1/12th) interest in the joint venture. Each of the other joint venturers had a one-sixth interest.

11. Paul invited the others to join the joint venture and drafted the Joint Venture Agreement.

12. The only capital contributed to Braemoor Associates was $3,000, consisting of $500 paid by each member, except the Jousmas who paid $250 each. The members of Braemoor Associates were generally wealthy.

13. Braemoor Associates assumed the obligations of the borrowers to the State Bank of Clearing for the loans set forth in paragraph 9 hereof.

14. Braemoor Associates also assumed the obligation of Paul to the Argo State Bank in the amount of $50,000, which had been used for the acquisition of the subject real estate and which was subsequently repaid by Braemoor Associates.

15. Braemoor Associates assumed the obligations of Mayes and Gustafson as "Developers" under the Annexation Agreement referred to in paragraph 7 hereof.

16. Gustafson and Mayes assigned their interest in the Agreement for Deed for the purchase of the Farm property to Braemoor Associates, and Braemoor Associates assumed the obligations of the purchasers under that Agreement.

17. On July 6, 1970, Braemoor Associates and Seneca entered into an Agreement for the construction of sewers, streets and other improvements on the Braemoor Estates property. Hulse was president of Seneca. The Agreement estimated the cost to be approximately $522,000. The final cost of the work was approximately $647,000.

18. As security for their obligation to Seneca, Braemoor Associates conveyed lots 27 to 67 in Braemoor Estates into Chicago City LT 8972, in which Seneca owned 100% of the beneficial interest and Hulse held the power of direction. Under the Agreement, Braemoor Associates was reuqired to pay Seneca the cost of construction, or $15,000 per lot, in order to withdraw the lots from the Trust.

19. On July 24, 1970 and October 2, 1970, Paul approved and caused the Bank to make loans of $24,000 and $100,000 on notes signed by Bennett and George Jousma, respectively. The loan proceeds were used for the benefit of Braemoor Associates. The loans have been repaid.

20. On December 15, 1970, Chicago City Bank made a loan of $500,000 to Braemoor Associates. The maturity date of this loan was December 15, 1972. The loan balance on this loan was $325,000 on March 15, 1971, and it was reduced to $312,500 on July 7, 1972. It was fully repaid on November 3, 1972.

21. The Chicago City Bank loan was secured by a pledge of the beneficial interest in Chicago City Bank LT 8825, which held title to Lots 1-4 and 6-26 in Braemoor Estates.

22. The proceeds of the Chicago City Bank loan were deposited into the Braemoor Associates' checking account at Chicago City Bank. On December 14 and 15, 1970, Braemoor Associates drew checks to repay $321,500 of the Bank's loans; to pay interest totalling $64,213.64 on the Bank's loans and the Agreement for Deed; and to pay other obligations assumed by Braemoor Associates. The total of the checks drawn by Braemoor Associates was $529,039. As a result, Braemoor's account was overdrawn from December 15, 1970 until February 24, 1971, when the proceeds of the Bank's $55,000 loan to Kaye were deposited into the account.

23. Paul approved and caused the Bank to make loans of $78,4000 to Bennett on January 20, 1971; $55,000 to Kaye on February 24, 1971; $100,000 to George Jousma on June 4, 1971; and $20,000 to Bennett on June 18, 1971.. All of the loan proceeds were used for the benefit of Braemoor Associates. These loans have been repaid.

24. On July 20, 1971, the Braemoor Associates entered into an Agreement to purchase a water system, including a water tower tank, from the Hinsdale Industrial District for $230,000 and signed Notes to evidence their liability under the Agreement. The dates of the payments due under the Agreement and the dates of the payments made by or on behalf of Braemoor Associates are as follows:

Amount	Due On Or Before	Paid
$60,000	Closing	8-23-71
60,000	12-31-71	1-14-72
60,000	6-30-72	6-30-72
50,000	12-31-72	11-17-72

25. The above Agreement further provided that if the property on which the water system was located was not annexed to the Village of Burr Ridge within one year, the Braemoor Associates were liable to pay an additional $100,000. Braemoor Associates entered into the Agreement in order to satisfy the obligation imposed on the "Developer" by paragraph 7A of the Annexation Agreement to acquire and convey to the Village of Burr Ridge a water system; including a water tower tank, at no cost to the Village of Burr Ridge.

26. Paul handled the negotiations for and drafting of the above Agreement, and arranged for the signing of the Agreement and Notes by the Braemoor Associates. Paul paid the first installment of $60,000 personally, and was later reimbursed by Braemoor Associates on September 30, 1971.

27. On August 23, 1971, Paul approved and caused the State Bank of Clearing to make a loan of $17,350 to Kaye. The proceeds of this loan were paid over by Kaye to Braemoor Associates for the purchase of a lot in Braemoor Estates. This loan was repaid.

28. In or about September, 1971, Paul and Ringbloom had discussions concerning the sale of the Condominium property. As the result of these discussions, an oral agreement was reached for the sale of the Condominium property to Western for $400,000, and Western paid $60,000 to Braemoor Associates on September 29, 1971, as an earnest money deposit.

29. Western made additional payments to Braemoor Associates of $60,000 on January 14, 1972, $80,000 on June 30, 1972, and a final payment of $200,000 on October 27, 1972 for the Condominium property.

30. On January 10, 1972, Paul approved and caused the State Bank of Clearing to make a loan of $60,000 to Ringbloom. At this time, Ringbloom individually had unpaid loans totalling $444,721.84 from the State Bank of Clearing.

31. The proceeds of this loan (together with the proceeds of a $165,000 loan which is not in issue) were deposited into the checking account of Western at the State Bank of Clearing on January 10, 1972. The balance in Western's account before the deposit of these funds was $18,931.78, less any outstanding checks. After said deposit and the payment of checks presented that day, the balance in Western's account was $233,249.43.

32. Western drew a check dated January 10, 1972, on its account for $60,000 payable to the order of Braemoor Associates, and on January 14, 1972 Hulse endorsed and deposited this check into Braemoor's checking account. This payment was reflected on Western's books and records and Braemoor Associates' records as the second partial payment by Western to Braemoor Associates of the purchase price for the Condo property.

33. Western would not have made the $60,000 payment to Braemoor Associates if the Bank had not made the $60,000 loan.

34. On January 14, 1972, Hulse and Paul drew a check on Braemoor Associates' account for $60,000 in payment of the $60,000 installment due for the water system. The check was mailed on January 19, 1972, to make that payment. After the foregoing transactions, the balance in the Braemoor Associates' checking account was $1,874.33.

35. In May, 1972, Illinois and Federal Reserve System bank examiners computed the total outstanding loans to Ringbloom,

Western, and certain other related entities to aggregate in excess of $1,895,000.

36. On or about July 14, 1972, Paul requested Marquette National Bank to make loans totalling $800,000 to Ringbloom and Western, to be used to repay in part the Ringbloom loans. Paul gave the Marquette National Bank written assurance that within 10 days the State Bank of Clearing would again lend Ringbloom at least $800,000 to enable him to repay the Marquette National Bank loans.

37. On July 14, 1972, the Marquette National Bank made a $400,000 loan to Western and a $400,000 loan to Ringbloom, neither of whom had previously been a customer of that bank. The loan proceeds were disbursed by checks deposited directly into the respective checking accounts of Western and Ringbloom at the State Bank of Clearing.

38. On July 24, 1972, the State Bank of Clearing made a loan of $335,000 to Ringbloom and a loan of $465,000 to Western. The loan proceeds were used to repay the two $400,000 loans owed to the Marquette National Bank. Specifically, the proceeds of the $335,000 loan were deposited into Ringbloom's account along with a check of Western's payable to Ringbloom for $65,000 (drawn out of the proceeds of Western's $465,000 loan). The total of $400,000 was then transferred by a debit memo to the Marquette National Bank.

39. On June 27, 1972, the balance in Braemoor Associates' checking account was $22,070. On or before June 30, 1972, Braemoor Associates was obligated to pay the following debts:

(a) $14,107.50 to LaSalle LT 24786 for interest due on the unpaid balance under the Agreement for Deed;

(b) $60,000 to Hinsdale Industrial District for the water tower pursuant to the Agreement and Note; and

(c) $12,500 to Chicago City Bank on its loan.

40. On June 26, 1972, Paul approved and caused the State Bank of Clearing to make a $25,000 loan to Charles R. Smith, an officer of Western, and on June 30, 1972, Paul approved and caused the State Bank of Clearing to make a $48,000 loan to View Enterprises (owned equally by Paul, Lambert and the two Jousmas). The proceeds of these loans were credited to Western's checking account at the State Bank of Clearing on June 30, 1972. Immediately prior to this deposit, Western's account had an overdraft balance of $10,568.61.

41. Western drew a check dated June 26, 1972, on its account payable to Braemoor Associates for $80,000, and Braemoor Associates deposited the check into its account on June 30, 1972. This payment was reflected on Western's records as the third partial payment by Western to Braemoor Associates for the Condo property.

42. On July 5, 1972, the proceeds of the Smith loan were transferred out of Western's account to Smith's account, an additional $35,000 was paid on other Western checks and the said $80,000 check was paid, all of which created an overdraft in Western's checking account at the State Bank of Clearing in the amount of $52,797.47 on July 5, 1972.

43. On June 30, 1972, Paul and Hulse drew checks on the Braemoor Associates' checking account to pay LaSalle LT 24786 $14,107.50 for interest due under the Agreement for Deed and to pay Hinsdale Industrial District $60,000 due under the Agreement for the water tower and system.

44. Sometime prior to July, 1972, Paul and Ringbloom discussed the sale of the Farm property. As the result of these discussions, Paul and Ringbloom orally agreed that Braemoor Associates would sell, and Ringbloom or Western would buy, the Farm property in 20 acre increments for $12,000 per acre. There has never been any written contract reflecting the terms of this agreement. No specific dates for payment were fixed by the oral agreement, except that Western would make at least one 20-acre purchase in approximately October of each year in order to furnish Braemoor Associates with the funds needed to make its annual $100,000 payment of principal, plus interest, to LaSalle LT 24786 for the Farm property.

45. As of July, 1972, Braemoor Associates owed Seneca over $436,000 for sewers, streets and other improvements constructed by Seneca on the Braemoor Estates property, pursuant to the Seneca contract of July 6, 1970. As of July, 1972, Braemoor Associates had sold 12 of the lots pledged to Seneca to secure the payments due under the Seneca contract, and was about to sell 4 more of the pledged lots to third parties. Under the Seneca contract, Braemoor Associates were required to pay Seneca $240,000 ($15,000 per lot) to obtain the release of the 16 lots from the pledge. Braemoor Associates, however, had insufficient funds available to pay Seneca to obtain the release of the lots, and Hulse, as president of Seneca, released the 12 lots without requiring prior payment.

46. As of July, 1972, Indian Trails Apartments, a Ringbloom venture, owed the State Bank of Clearing $167,567.71 on three loans.

47. On July 14, 1972, Paul approved and caused the State Bank of Clearing to make a loan of $417,567.71 to Lambert on a note which Lambert had signed in blank at Paul's request and left with Paul. The proceeds of the loan were credited to Lambert's checking account at the State Bank of Clearing. On July 17, 1972, the State Bank of Clearing, at Paul's direction, transferred $167.567.71 out of Lambert's checking account to pay the three Indian Trails Apartments loans, and transferred the remaining $250,000 from Lambert's checking account to Western's checking account at the State Bank of Clearing. Lambert did not owe Western $250,000, or any other amount. Prior to such transfer, Western's checking account had an overdraft balance of $26,263.

48. On July 17, 1972, Western paid $240,000 of the above $250,000 to Braemoor Associates, after which Western's checking account was again overdrawn by $12,972.50. On July 25, 1973, Braemoor Associates paid this $240,000 to Seneca.

49. On August 1, 1972, Paul caused the State Bank of Clearing to make a $500,000 loan to Albany Supply Company (which was wholly owned by American Contractors, Inc., which was wholly owned by Western of which Ringbloom was the sole shareholder) and a $150,000 loan to Ringbloom Construction Company (which was also owned by Ringbloom).

50. On August 1, 1972, Albany Supply Company and Ringbloom Construction Company each paid $125,000 of these loan proceeds to Western. Prior to this deposit, Western's account was overdrawn in excess of $18,000.

51. Western issued its undated check for $250,944.45 payable to Lambert. Paul caused this check to be credited to

Lambert's checking account at the State Bank of Clearing. After these transactions, Western's checking account was again overdrawn in excess of $37,000.

52. Paul then caused the State Bank of Clearing to transfer the said $250,944.45 out of Lambert's checking account to pay part of Lambert's July 14, 1972 loan.. The above Albany Supply Company and Ringbloom Construction Company loans remain unpaid.

53. The $165,567.17 balance of the Lambert loan was paid with the proceeds of three new loans which Paul caused the State Bank of Clearing to make to Indian Trails Apartments on August 2, 1972. These three loans were also acquired by the FDIC in the transaction described in paragraph 2 above, and FDIC has settled them for $125,000.

54. Braemoor Associates owed Chicago City Bank $28,000 for accrued interest by October 31, 1974. However, from October 14, 1974 through October 29, 1974, Braemoor Associates had only $2,891.82 in its checking account.

55. On October 30, 1974, Lambert permitted the State Bank of Clearing to make a $36,500 loan to Kaye, the proceeds of which were deposited into Kaye's business account at the State Bank of Clearing.

56. On October 31, 1974, Kaye paid $32,000 of the $36,500 loan proceeds to Braemoor Associates and $4,369.88 of the proceeds to the State Bank of Clearing for interest on a loan to Universal Art Products.

57. On October 29, 1974, Braemoor Associates drew a check for $28,000 to pay Chicago City Bank for the accrued interest.

58. Kaye's purpose in obtaining the October 30, 1974 loan was to enable Braemoor Associates to pay the $28,000 due to Chicago City Bank, and to enable Kaye to pay accrued interest on the Universal Art Products loan.

59. Braemoor Associates suffered losses in each year, except 1972, as follows:

1970 loss			(96,879)
1971 loss			(100,387)
1972	ordinary loss	(239,182)	
	capital gain	+490,732	
	net profit		251,548
1973	ordinary loss	(320,125)	
	capital gain	+128,460	
	net loss		(191,665)
1974	ordinary loss	(61,356)	
	capital gain	+ 1,237	
	net loss		(60,029)
1975 loss			(87,358)
	6-year ordinary loss	(905,288)	
	6-year capital gain	+620,519	
	Net 6-year loss		(284,769)

60. The State Bank of Clearing did not have a loan committee which would review applications for loans at the time of these transactions.

61. Paul had exercised nearly exclusive control of the decision making process in rejecting or approving commercial loans at the State Bank of Clearing at the time of these transactions.

62. The court finds that the testimony of all of the defendants is credible.

63. The defendants had no actual knowledge of the loan transactions in issue.

64. The defendants did not participate in the loan transactions at issue.

65. The defendants had no actual knowledge of Paul's breach of his fiduciary duties to the bank.

66. The circumstances of the financial transactions between the defendants and Paul were not so extraordinary that the defendants should have known of Paul's breach of trust nor were the defendants in possession of such facts sufficient to alert a reasonable person to inquire whether Paul was breaching his trust.

67. The defendants did not expressly delegate to Paul the authority to arrange financing for the purchase of the Braemoor properties.

68. The defendants did not impliedly delegate to Paul the authority to arrange financing for the purchase of the Braemoor properties.

69. The loan transactions at issue were made for the purchase of property rather than as a device for the purpose of financing the Braemoor partnership.

70. There is no evidence of an agreement, either express or implied, between the defendants and Paul to conceal Paul's interest in the Braemoor partnership.

71. At the time of the transactions at issue, the defendants, both in their individual capacities and as a partnership, had sufficient sources of credit other than the State Bank of Clearing to meet their obligations as they became due.

CONCLUSIONS OF LAW

Count I, Plaintiff's Claim for the Imposition of a Constructive Trust

1. The plaintiff's burden of proof in an action which requests the court to impose a constructive trust requires that the plaintiff prove its case by evidence which is "so strong, unequivocal and unmistakable as to lead to one conclusion." Henrichs v. Sundmaker, 405 Ill. 62, 89 N.E. 2d 732 (1950).

2. Where a partnership is charged with a breach of trust of a partner, the plaintiff must prove that the partners had knowledge of the breach of trust or that they participated in the breach of trust. Penn v. Fogler, 182 Ill. 76 (1899).

3. The plaintiff must also prove, in an action against a partnership arising out of a partner's breach of trust, that the defendants possessed knowledge of facts that would lead a reasonably intelligent and diligent person to make inquiry as to whether the trustees were committing a breach of trust. Kurowski v. Burch, 8 Ill. App. 3d 716, 720 (1972).

4. In the present case, the plaintiff has failed to prove by clear convincing and unequivocal evidence that the defendants had actual knowledge of Paul's breach of trust nor did the plaintiff prove that the defendants participated in this breach or that they were in possession of facts which would lead them to inquire whether Paul had in fact breached his duties as a fiduciary.

Count II, Plaintiff's Conspiracy Claim

5. In a claim alleging a civil conspiracy, the plaintiff must prove his case by clear convincing evidence ABC Trans. Nat. Etc. v Aeronautics Forwarders, 90 Ill.App. 3d 817, 413 N.E. 2d 1299 (1980)

6. Where the evidence presented leads to inferences which are equally consistent with innocent conduct as with guilt, it is the court's duty to find that the conspiracy has not been proven. ABC Trans. Nat. Etc. v. Aeronautics Forwarders, 90 Ill. App. 3d 816, 413 N.E. 2d 1299 (1980).

7. A civil conspiracy has been defined as a "combination of two or more persons acting in concert to commit an unlawful act, or to commit a lawful act by an unlawful means, the principal element of which is an agreement between the parties to inflict a wrong against or injury upon another and an overt act that results in damage." Hampton v. Hanrahan, 600 F.2d 600, 620 (7th Cir. 1979).

8. The plaintiff has failed to prove by clear and convincing evidence the existence of an agreement, either express or implied, with Paul to commit an unlawful act or to commit a lawful act by an unlawful means.

9. The plaintiff has failed to prove by clear and convincing evidence the existence of an agreement between defendants, Paul, and Ringbloom to obtain loans from the State Bank of Clearing for the benefit of Braemoor Associates without disclosing Paul's financial interest in Braemoor Associates.

Count III, Plaintiff's Claim for Unjust Enrichment

10. The court finds that the plaintiff has abandoned its claim for unjust enrichment.

11. If the plaintiff had presented this claim in its findings of fact and conclusions of law, the court would refuse to impose a constructive trust for the reasons set forth in the

court's conclusions of law related to Count I.

For the foregoing reasons, the defendants' motion for involuntary dismissal of the plaintiff's claims pursuant to Rule 41(b), Fed. R. Civ. P. is GRANTED. The plaintiff's claims are hereby dismissed with prejudice.

It is so ordered.

Nicholas J. Bua
Judge, United States District Court

DATED: November 16, 1981

In the

United States Court of Appeals

For the Seventh Circuit

No. 81-3040

FEDERAL DEPOSIT INSURANCE CORPORATION,

Plaintiff-Appellant,

v.

BRAEMOOR ASSOCIATES, et al.,

Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 76 C 3295—Nicholas J. Bua, *Judge.*

ARGUED JUNE 11, 1982—DECIDED AUGUST 13, 1982

Before WOOD and POSNER, *Circuit Judges*, and CAMPBELL, *Senior District Judge.**

POSNER, *Circuit Judge.* The Federal Deposit Insurance Corporation, as successor in interest to a defunct Illinois state bank, the State Bank of Clearing, brought this suit against Braemoor Associates, a joint venture, and against five individuals who are the surviving joint venturers in Braemoor, seeking to recover bank monies that the bank's president, Paul Bere, had funneled to Braemoor in breach of his fiduciary obligations to the bank. The asserted basis of federal jurisdiction over the suit is 12 U.S.C. § 1819 Fourth, which provides that "all

* Of the Northern District of Illinois.

suits of a civil nature at common law or in equity to which the [Federal Deposit Insurance] Corporation shall be a party shall be deemed to arise under the laws of the United States, and the United States district courts shall have original jurisdiction thereof, without regard to the amount in controversy . . . ." There was a bench trial, but at the close of the FDIC's case the defendants moved for dismissal of the complaint under Rule 41(b) of the Federal Rules of Civil Procedure, and the motion was granted.

We consider first, as we must though no party to this litigation has raised the question, whether the federal courts have jurisdiction over the subject matter of the litigation. Section 1819 Fourth excepts from its grant of jurisdiction to those courts any suit to which the FDIC "is a party in its capacity as receiver of a State bank and which involves only the rights or obligations of depositors, creditors, stockholders, and such State bank under State law . . . ." When the State Bank of Clearing was closed down, the Illinois banking commissioner appointed the FDIC as receiver, see Ill. Rev. Stat. 1981, ch. 17, § 370, and the FDIC accepted appointment pursuant to 12 U.S.C. § 1821(e). Had the FDIC brought this suit—a suit to impose a constructive trust by reason of Paul Bere's violation of his fiduciary obligations under state law—in its capacity as receiver, the proviso, quoted above, to the grant of federal jurisdiction in section 1819 Fourth would have prevented the FDIC from maintaining the suit in federal court, at least under that section, which is the only basis of federal jurisdiction alleged. *FDIC v. Sumner Financial Corp.*, 602 F.2d 670, 679-80 (5th Cir. 1979). The complaint goes on to allege, however, that the FDIC, in conformity with Illinois law, used its position as receiver to transfer to itself certain bank assets, including the bank's cause of action against the defendants, and that it is suing in its capacity as owner of those assets rather than in its capacity as receiver. These allegations have not been denied; nor is there any doubt that the FDIC has authority under federal law to obtain bank assets in this fashion. See 12 U.S.C. §§ 1821(e), 1823(e). And when the FDIC is suing

to realize on such assets there is federal jurisdiction under section 1819 Fourth. *FDIC v. Ashley*, 585 F.2d 157, 161-62 (6th Cir. 1978).

The only novelty is that the asset that the FDIC is suing to realize on in this case is a cause of action, rather than as in the usual case a note or other financial instrument. *Ashley* is some authority for the proposition that this makes no difference, because the court in *Ashley* mentioned that the assets that had been transferred to the FDIC included causes of action against the bank's directors, 555 F.2d at 160; but since the opinion contains no separate discussion of these assets, we cannot be certain that the court would have thought them enough to support federal jurisdiction over the suit. The difficulty with basing jurisdiction solely on such an asset is that the enforcement of a bank's cause of action is precisely the sort of thing that a receiver would do, and the receiver's action in transferring the cause of action to itself therefore seems like an effort—a rather transparent one at that—to get around the jurisdictional limitations in section 1819 Fourth.

But we think it is necessary to distinguish between a transfer for value and one not for value. If the FDIC purchased the claims of the State Bank of Clearing against these defendants that would be the bona fide acquisition of a genuine asset, and a suit to realize on that asset would not be a suit in the FDIC's capacity as a receiver. Cf. *Ashley, supra*, 585 F.2d at 162; *FDIC v. Godshall*, 558 F.2d 220, 223 (4th Cir. 1977). The complaint alleges, without contradiction, that the transfer of assets to the FDIC was in accordance with Illinois law and was consented to by the circuit court of Cook County; and we think it unlikely, to say the least, that the circuit court would have allowed the FDIC to pocket assets of the State Bank of Clearing without giving anything in return. We find nothing in the Illinois Banking Act that would authorize such conduct. See Ill. Rev. Stat. 1981, ch. 17, §§ 372-73. We also think there is no question of the assignability of the bank's claim to the FDIC. See *Pattiz v. Semple*, 12 F.2d 276 (E.D. Ill. 1926), aff'd, 18 F.2d 955 (7th Cir. 1927). Of course it is possible that the

jurisdictional allegations are a lie—that the FDIC and the defendants are colluding to confer jurisdiction on the federal courts in contravention of the limitations in section 1819 Fourth—but we do not think that our obligation to police the limitations on our jurisdiction requires us to investigate such a hypothesis. We conclude that we have jurisdiction, though we deprecate the FDIC's failure to allege more fully the facts establishing federal jurisdiction.

There is another threshold issue not raised by the parties, and though it does not go to subject-matter jurisdiction we shall consider it on our own initiative. It is whether the substantive law to be applied in this case is federal common law or state law (if the latter, the state whose law applies is clearly Illinois). From the predominance of Illinois citations in the briefs and in the district court's conclusions of law we infer that the parties and the district court assumed that Illinois law supplied the rule of decision; but they did not say so, and it is at least possible, in light of the language of 12 U.S.C. § 1819 Fourth and certain judicial decisions, that they thought federal common law applied but was identical to Illinois law.

We expressed recently and remark once again our queasiness at being asked to decide an appeal without being told by the district court what substantive law to apply—state or federal, and if the former which state's law it is. *Central Soya Co. v. Epstein Fisheries, Inc.*, 676 F.2d 939, 941 (7th Cir. 1982). In some cases insistence on an explicit statement of the source of law would be pedantic, but not here. Maybe the "arising under" language of section 1819 Fourth is just a redundant way of conferring jurisdiction on the federal courts rather than a direction to those courts to create a common law of rights and obligations of the FDIC; but an unbroken line of decisions beginning with *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447 (1942), holds that the substantive law to be applied in suits to which the FDIC is a party is indeed federal common law, not state law. See *FDIC v. Timbalier Towing Co.*, 497 F. Supp. 912, 918 (N.D. Ohio 1980), and cases cited there. When the FDIC is

suing as a receiver appointed under state law the applicable substantive law is state rather than federal, *FDIC v. Leach*, 525 F. Supp. 1379, 1384 (E.D. Mich. 1981), but as we have pointed out this is not such a suit and could not be brought in federal court if it were.

However, the *D'Oench* line of cases is not so devastating to the approach taken below as might appear. As we noted recently in considering a related question—whether state or federal common law should supply the rule of decision for cases involving the construction of U.S. Postal Service leases—one choice for the federal common law judge is to adopt local law as the rule of decision. *Powers v. United States Postal Serv.*, 671 F.2d 1041, 1043 (7th Cir. 1982). That choice is attractive in the present case given the nature of the FDIC's claim.

The FDIC is suing as the assignee of the State Bank of Clearing's cause of action under state law against the defendants, and it is difficult to see why assignment to the FDIC should alter or enlarge that cause of action. *D'Oench*, though the Supreme Court refused in that case to follow state law, does not support such a metamorphosis. In *D'Oench* the FDIC had lent money to a bank that it had insured, and had received a note as collateral; and the question on which the Court refused to follow state law was whether the FDIC was a holder in due course, so that it could collect on the note free of the defenses that the payor might have had against the original payee. *D'Oench* was thus a case involving the rights of the United States in contracts to which it is a party, and is one of several cases all decided at about the same time that suggest that the rule of decision in such cases should be federal rather than state. See *Clearfield Trust Co. v. United States*, 318 U.S. 363, 367 (1943); *United States v. County of Allegheny*, 322 U.S. 174, 183 (1944); *Priebe & Sons, Inc. v. United States*, 332 U.S. 407, 411 (1947). Whatever the contemporary vitality of these cases—on which see *In re Murdock Machine & Engineering Co. of Utah*, 620 F.2d 767, 772 (10th Cir. 1980), and *Powers v. United States Postal Serv., supra*, 671 F.2d at 1045—they do not control the present case: it does not involve a contract to which the FDIC is a party.

True, the FDIC has a vital stake in any asset of a defunct bank that it has insured; the statute under which it operates contemplates the transfer of assets, presumably including causes of action, from such a bank to the FDIC, see 12 U.S.C. §§ 1823(d), (e); and *D'Oench* teaches that an asset can confer on its holder greater rights when it comes into the hands of the FDIC. These considerations, coupled with the language of section 1819 Fourth, suggest that in an appropriate case a federal court could reject state substantive law if that was necessary to protect the FDIC's interest in minimizing depositor losses which it must make good. But the absence of any ready-made federal common law in most of the areas of law in which it might be applied, and a general reluctance to displace state law without explicit statutory or constitutional direction to do so, support a presumption that state law is adequate and should be adopted by the federal court as the rule of decision. See *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 740 (1979); *Powers v. United States Postal Serv.*, *supra*, 671 F.2d at 1045. The presumption is unrebutted here, so we can turn at last to the merits.

Braemoor Associates was formed in 1970 by several individuals, including Paul Bere, the president and board chairman of the State Bank of Clearing, to develop real estate. (Bere died before this suit was brought, and neither he nor his estate is a defendant.) Between 1970 and 1972 Bere caused the bank to make nine loans, totaling more than $500,000, to various of the joint venturers for use by Braemoor. These loans violated state law. Although it is not unlawful per se for an Illinois bank to make a loan to its officers, or to enterprises which the officers control or actively manage, such loans—if they exceed $10,000, as each of the nine loans did—require the approval of the bank's board of directors, see Illinois Banking Act, § 37(1), Ill. Rev. Stat. 1981, ch. 17, § 347(1), and that approval was not sought or given for any of the loans. However, all these loans were eventually repaid to the bank and are not in issue here.

Ringbloom, a real estate entrepreneur with whom Paul Bere had extensive business dealings, owned a company called Western. Bere and Ringbloom agreed that Western would purchase some land owned by Braemoor but the terms of payment were left somewhat indefinite. Late in 1971 Braemoor found itself owing a $60,000 installment payment to Seneca, a company whose president, Hulse, was one of the joint venturers in Braemoor, on a contract to build streets and sewers for Braemoor. Braemoor had less than $2000 in its bank account. Bere asked Ringbloom to pay Braemoor $60,000 on account of Western's land purchase so that Braemoor could pay Seneca, but Ringbloom said that Western did not have the money. Bere thereupon had the State Bank of Clearing lend Ringbloom $60,000 and Ringbloom immediately made out a check drawn on Western's bank account in the State Bank of Clearing for the same amount, payable to Braemoor. Ringbloom handed the check to Bere, who gave it to Hulse, who deposited it in Braemoor's bank account. Braemoor then paid Seneca $60,000. The $60,000 loan from the State Bank of Clearing to Ringbloom was not submitted to or approved by the bank's board of directors. It is the first of the two loan transactions at issue in this case.

Several months later Braemoor needed to pay Seneca another installment on the street and sewer contract, this one for $240,000, in order to get Seneca to release some lots that Braemoor wanted to sell. Braemoor had only $16,000 in its bank account. Again Bere turned to Ringbloom, though Western was not due to make a payment to Braemoor on its land purchase agreement at that time. Again Western did not have the money, and again Bere stepped into the breach with a loan from his bank. This transaction was more intricate than the previous one. Bere had previously asked his brother, Lamber Bere, another of the joint venturers in Braemoor, to sign a note in blank payable to the State Bank of Clearing and to leave the note with him, Paul; and Lambert had done so. Paul now completed the note by making it out for $417,000, and directed the bank to lend this amount to Lambert. The money was deposited in a joint

account maintained by Lambert and his wife at the State Bank of Clearing. A few days later Paul caused the entire amount to be transferred out of the account. At his direction, $167,000 was used to pay off loans that one of Ringbloom's companies had gotten from the bank, and the other $250,000 was deposited in Western's checking account at the bank. Western made out a check for $240,000 to Braemoor on the same day. From that point on the transaction was handled identically to the $60,000 loan.

The $240,000 payment to Braemoor is the second transaction at issue in this case. Lambert testified that he was stunned to receive his July 1972 bank statement showing a credit and offsetting debits for $417,000 and that he asked Paul about them but never received an explanation. The $417,000 loan was not submitted to or approved by the bank's board of directors.

The $60,000 loan to Western that found its way into Braemoor's pockets and the $240,000 portion of the second loan that also found its way into Braemoor's pockets were made in violation of Paul Bere's fiduciary obligations to his bank under section 37(1) of the Illinois Banking Act; and the question is whether this breach of trust may be imputed to Braemoor. If so, it is not disputed that the FDIC may recover the proceeds of the breach in the hands of Braemoor; and since the principles of partnership law apply to joint ventures of individuals, *Smith v. Metropolitan Sanitary District of Greater Chicago*, 77 Ill. 2d 313, 318, 396 N.E.2d 524, 527 (1979), there is also no question that if Braemoor is liable so are the individual defendants.

The district court found that the FDIC had failed to prove that the defendants had either (1) actual knowledge of Paul Bere's breach of trust or (2) knowledge of such facts as would lead a reasonable man to inquire whether Bere was committing a breach of trust; and the court concluded that without such proof the FDIC could not prevail. The FDIC does not challenge the finding that the defendants had no actual knowledge of the breach of trust, but it argues that the finding that they had no constructive notice is clearly erroneous and that

in any event there are alternative grounds for recovering the monies sued for that have nothing to do with what the joint venturers, other than Paul Bere himself, may have known, so that the district court's legal conclusion is incorrect even if none of its factfindings is.

We need not decide whether either factfinding is clearly erroneous. The FDIC's right to recover the proceeds of the two payments to Braemoor under the provisions of the Uniform Partnership Act (adopted in Illinois) is independent of what the other joint venturers knew, or as reasonable men should have known, about Paul Bere's breach of trust. Although the district court did not discuss the defendants' liability under the Uniform Partnership Act, the defendants do not contend that this theory of liability was not before the district court and should not be considered by us.

A joint venture of individuals is subject to the Uniform Partnership Act, *Mobil Oil Corp. v. Hurwitz*, 63 Ill. App. 3d 430, 380 N.E.2d 49 (1978), as indeed the Braemoor joint venture agreement expressly recites. Section 12 of the Act, Ill. Rev. Stat. 1981, ch. 106½, § 12, provides that "the knowledge of the partner acting in the particular matter, acquired while a partner or then present to his mind, . . . operate[s] as . . . knowledge of the partnership, except in the case of a fraud on the partnership committed by or with the consent of that partner." Paul Bere, a partner in Braemoor, knew that in funneling $300,000 of his bank's money to Braemoor through Ringbloom, Western, and Lambert Bere he was violating his fiduciary duty to the bank under section 37(1) of the Illinois Banking Act. Section 12 of the Uniform Partnership Act "imputed" that knowledge to the other joint venturers, which is to say made them and Braemoor, despite their lack of knowledge, fully liable for the breach of trust and hence constructive trustees of the proceeds of that breach for the benefit of the bank and its successor in interest, the FDIC, just as Paul Bere would have been if the FDIC had sued him. See *Howard v. Hamilton*, 28 N.C. App. 670, 675, 222 S.E.2d 913, 917 (1976). The exception in section 12 of the Uniform Partnership Act for frauds on the partner-

ship is not applicable to this case, because Paul Bere was committing fraud on behalf of rather than against the partnership. Cf. *Maclay v. Kelsey-Seybold Clinic*, 456 S.W.2d 229, 234 (Tex. Civ. App. 1970), aff'd, 466 S.W.2d 716, 719 (Tex. 1971); *Cenco Inc. v. Seidman & Seidman*, Nos. 81-2116, 81-2264, slip op. at 11-12 (7th Cir. March 26, 1982). We neither see, nor desire to concoct, any escape from the language of section 12. "The rule which imposes civil liability upon an 'innocent' partner for bad faith dealing of a co-partner is most pointedly applicable where the co-partner participates in the benefits derived from the dealing in bad faith." *Higgins v. Shenango Pottery Co.*, 256 F.2d 504, 509 (3d Cir. 1958), construing an identically worded predecessor provision to section 12.

We reach the same conclusion by an alternative route. Section 13 of the Uniform Partnership Act, Ill. Rev. Stat. 1981, ch. 106½, § 13, provides that "where, by any wrongful act or omission of any partner acting in the ordinary course of the business of the partnership, or with the authority of his co-partners, loss or injury is caused to any person, not being a partner in the partnership, . . . the partnership is liable therefor to the same extent as the partner so acting or omitting to act." There is no doubt that Paul Bere's violation of section 37(1) of the Illinois Banking Act caused an injury to the bank (and hence to its successor in interest, the FDIC), so that Braemoor is liable if Bere was acting either "in the ordinary course of [Braemoor's] business" or "with the authority of" the other joint venturers; and we think he was doing both. The nine loans made at Paul Bere's direction by the State Bank of Clearing to the individual joint venturers for the benefit of Braemoor show that Bere was acting in the ordinary course of Braemoor's business when he channeled bank money to Braemoor in violation of the Illinois Banking Act. This is perfectly clear with respect to the nine loans themselves and scarcely less so with respect to the two loans in issue here. The fact that the money went from the bank to Braemoor through Ringbloom and Western, or as in the second transaction through Ringbloom, Western, and Lambert Bere, rather than directly, is a detail.

They were transactions, "laundered" transactions to be sure, by which Paul channeled the bank's money to Braemoor; and the financing of Braemoor by the bank had become the ordinary course of business for Braemoor. Cf. *Zemelman v. Boston Ins. Co.*, 4 Cal. App. 3d 15, 84 Cal. Rptr. 206 (1970).

We also think his partners authorized Paul Bere to channel bank money to Braemoor. They knew, from the eight of the nine loans that predated the two loans in issue, that Bere was channeling money from his bank to Braemoor, and they obviously approved, and thereby authorized, his doing so. We can imagine no theory under which Paul Bere was authorized to borrow upwards of $500,000 from the bank directly for Braemoor but not to borrow additional sums indirectly, through Ringbloom and Western. Why should his co-venturers have cared what route the money followed from its source? This is not to say that the actual violation of the Illinois Banking Act was authorized; we accept the district court's finding that the other venturers did not know of any such violation. But section 13 of the Uniform Partnership Act requires only that the partner who commits the wrong be acting with the authorization of his partners when he does so—not that the violation itself be authorized, see *Elle v. Babbitt*, 488 P.2d 440, 446-47 (Ore. 1971)—and Paul Bere was acting with that authorization when he committed the violation; he was not off on some frolic of his own. As for the district court's finding that "the defendants did not impliedly delegate to Paul the authority to arrange financing for the purchase of the Braemoor properties," we do not understand its relevance. The loans in issue were not for the purchase of any properties; they were for a street and sewer system on property already owned by Braemoor.

There is nothing novel or exotic about the principles embodied in sections 12 and 13 of the Uniform Partnership Act or their application to the facts of this case. The two sections, section 13 especially, merely extend to partnerships familiar principles of agency law, among them the principle of *respondeat superior*, whereby an

employer is liable for the torts of his employees committed in the course of their employment. The extension of this principle to partnerships antedates the Uniform Partnership Act. See *Hamlyn v. John Houston & Co.*, 1903 L.R. 1 K.B. 81 (C.A. 1902). The district court erred by limiting its analysis to the distinct principles that govern cases where property that has been obtained in breach of trust comes into the hands of a third party who is not the principal or agent or partner of the person who committed the breach or is otherwise linked to him by a preexisting relationship, but is a stranger, and the question is whether the stranger has sufficient notice of the breach of trust to be forced to disgorge the property. See *Kurowski v. Burch*, 8 Ill. App. 3d 716, 720, 290 N.E.2d 401, 405 (1972), aff'd, 57 Ill. 2d 292, 312 N.E.2d 284 (1974); Restatement of Restitution § 168(2) (1937); 4 Scott, The Law of Trusts §§ 296-97 (3d ed. 1967). The law imposes greater duties on people with regard to the acts of their agents and partners than with regard to the acts of strangers, presumably to give people an incentive to choose carefully with whom to enter into ventures that may injure innocent third parties.

So we need not consider whether the district court, treating this as if it were a case where the breaching trustee and the constructive trustee were strangers rather than partners, was correct in concluding as a matter of fact that the joint venturers lacked knowledge of such facts as would have led reasonable men to inquire further into whether Paul Bere was committing a breach of trust—though we shall not conceal our skepticism that Lambert Bere did all that a reasonable man should have done to inquire into the circumstances whereby $417,000 passed mysteriously in and out of his bank account in a space of days. The liability of the joint venturers under the Uniform Partnership Act is independent of their knowledge—whether actual or, under general principles of restitution, constructive—of Paul Bere's breach of trust.

The FDIC has still another theory of liability—that the defendants conspired with Paul Bere to commit a

breach of trust against the bank. The district court rejected this theory on the facts, finding that the FDIC had failed to prove that the defendants actually knew of Bere's breach of trust. This finding is at least plausible; although they knew he was borrowing money from the bank for his joint venture his borrowing would not have been a breach of trust had Bere gotten the permission of his board of directors, a matter on which the defendants could not be presumed to be informed. At any rate we cannot say that the district court's finding was clearly erroneous, so we affirm this part of its judgment. However, the rejection of the FDIC's theory of liability under the Uniform Partnership Act was erroneous, and the judgment dismissing the complaint must therefore be reversed and the case remanded for further proceedings consistent with this opinion.

So Ordered.

A true Copy:

Teste:

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Clerk of the United States Court of Appeals for the Seventh Circuit

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AMENDED

In the

United States Court of Appeals

For the Seventh Circuit

No. 81-3040

FEDERAL DEPOSIT INSURANCE CORPORATION,

Plaintiff-Appellant,

v.

BRAEMOOR ASSOCIATES, et al.,

Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division. No. 76 C 3295—Nicholas J. Bua, *Judge.*

ARGUED JUNE 11, 1982—DECIDED AUGUST 13, 1982
AMENDED OCTOBER 28, 1982*

Before WOOD and POSNER, *Circuit Judges,* and CAMPBELL, *Senior District Judge.***

POSNER, *Circuit Judge.* The Federal Deposit Insurance Corporation, as successor in interest to a defunct Illinois state bank, the State Bank of Clearing, brought this suit against Braemoor Associates, a joint venture, and against five individuals who are the surviving joint venturers in Braemoor, seeking to recover bank monies

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* This amended opinion is issued in response to the petition for rehearing. In light of the amended opinion, the petition for rehearing is denied.

** Of the Northern District of Illinois.

that the bank's president, Paul Bere, had funneled to Braemoor in breach of his fiduciary obligations to the bank. The asserted basis of federal jurisdiction over the suit is 12 U.S.C. § 1819 Fourth, which provides that "all suits of a civil nature at common law or in equity to which the [Federal Deposit Insurance] Corporation shall be a party shall be deemed to arise under the laws of the United States, and the United States district courts shall have original jurisdiction thereof, without regard to the amount in controversy . . . ." There was a bench trial, but at the close of the FDIC's case the defendants moved for dismissal of the complaint under Rule 41(b) of the Federal Rules of Civil Procedure, and the motion was granted.

We consider first, as we must though no party to this litigation has raised the question, whether the federal courts have jurisdiction over the subject matter of the litigation. Section 1819 Fourth excepts from its grant of jurisdiction to those courts any suit to which the FDIC "is a party in its capacity as receiver of a State bank and which involves only the rights or obligations of depositors, creditors, stockholders, and such State bank under State law . . . ." When the State Bank of Clearing was closed down, the Illinois banking commissioner appointed the FDIC as receiver, see Ill. Rev. Stat. 1981, ch. 17, § 370, and the FDIC accepted appointment pursuant to 12 U.S.C. § 1821(e). Had the FDIC brought this suit—a suit to impose a constructive trust by reason of Paul Bere's violation of his fiduciary obligations under state law—in its capacity as receiver, the proviso, quoted above, to the grant of federal jurisdiction in section 1819 Fourth would have prevented the FDIC from maintaining the suit in federal court, at least under that section, which is the only basis of federal jurisdiction alleged. *FDIC v. Sumner Financial Corp.*, 602 F.2d 670, 679-80 (5th Cir. 1979). The complaint goes on to allege, however, that the FDIC, in conformity with Illinois law, used its position as receiver to transfer to itself certain bank assets, including the bank's cause of action against the defendants, and that it is suing in its capacity as owner of those assets rather than in its capacity as receiver. These allegations have not been denied; nor is

there any doubt that the FDIC has authority under federal law to obtain bank assets in this fashion. See 12 U.S.C. §§ 1821(e), 1823(e). And when the FDIC is suing to realize on such assets there is federal jurisdiction under section 1819 Fourth. *FDIC v. Ashley*, 585 F.2d 157, 161-62 (6th Cir. 1978).

The only novelty is that the asset that the FDIC is suing to realize on in this case is a cause of action, rather than as in the usual case a note or other financial instrument. *Ashley* is some authority for the proposition that this makes no difference, because the court in *Ashley* mentioned that the assets that had been transferred to the FDIC included causes of action against the bank's directors, 555 F.2d at 160; but since the opinion contains no separate discussion of these assets, we cannot be certain that the court would have thought them enough to support federal jurisdiction over the suit. The difficulty with basing jurisdiction solely on such an asset is that the enforcement of a bank's cause of action is precisely the sort of thing that a receiver would do, and the receiver's action in transferring the cause of action to itself therefore seems like an effort—a rather transparent one at that—to get around the jurisdictional limitations in section 1819 Fourth.

But we think it is necessary to distinguish between a transfer for value and one not for value. If the FDIC purchased the claims of the State Bank of Clearing against these defendants that would be the bona fide acquisition of a genuine asset, and a suit to realize on that asset would not be a suit in the FDIC's capacity as a receiver. Cf. *Ashley, supra*, 585 F.2d at 162; *FDIC v. Godshall*, 558 F.2d 220, 223 (4th Cir. 1977). The complaint alleges, without contradiction, that the transfer of assets to the FDIC was in accordance with Illinois law and was consented to by the circuit court of Cook County; and we think it unlikely, to say the least, that the circuit court would have allowed the FDIC to pocket assets of the State Bank of Clearing without giving anything in return. We find nothing in the Illinois Banking Act that would authorize such conduct. See Ill. Rev. Stat. 1981, ch. 17, §§ 372-73. We also think there is no question of the assignability of the bank's claim to the FDIC. See

Pattiz v. Semple, 12 F.2d 276 (E.D. Ill. 1926), aff'd, 18 F.2d 955 (7th Cir. 1927). Of course it is possible that the jurisdictional allegations are a lie—that the FDIC and the defendants are colluding to confer jurisdiction on the federal courts in contravention of the limitations in section 1819 Fourth—but we do not think that our obligation to police the limitations on our jurisdiction requires us to investigate such a hypothesis. We conclude that we have jurisdiction, though we deprecate the FDIC's failure to allege more fully the facts establishing federal jurisdiction.

There is another threshold issue not raised by the parties, and though it does not go to subject-matter jurisdiction we shall consider it on our own initiative. It is whether the substantive law to be applied in this case is federal common law or state law (if the latter, the state whose law applies is clearly Illinois). From the predominance of Illinois citations in the briefs and in the district court's conclusions of law we infer that the parties and the district court assumed that Illinois law supplied the rule of decision; but they did not say so, and it is at least possible, in light of the language of 12 U.S.C. § 1819 Fourth and certain judicial decisions, that they thought federal common law applied but was identical to Illinois law.

We expressed recently and remark once again our queasiness at being asked to decide an appeal without being told by the district court what substantive law to apply—state or federal, and if the former which state's law it is. *Central Soya Co. v. Epstein Fisheries, Inc.*, 676 F.2d 939, 941 (7th Cir. 1982). In some cases insistence on an explicit statement of the source of law would be pedantic, but not here. Maybe the "arising under" language of section 1819 Fourth is just a redundant way of conferring jurisdiction on the federal courts rather than a direction to those courts to create a common law of rights and obligations of the FDIC; but an unbroken line of decisions beginning with *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447 (1942), holds that the substantive law to be applied in suits to which the FDIC is a party is indeed federal common law, not state law. See *FDIC v. Timbalier Towing Co.*, 497 F. Supp. 912, 918 (N.D. Ohio 1980), and cases cited there. When the FDIC is

suing as a receiver appointed under state law the applicable substantive law is state rather than federal, *FDIC v. Leach*, 525 F. Supp. 1379, 1384 (E.D. Mich. 1981), but as we have pointed out this is not such a suit and could not be brought in federal court if it were.

However, the *D'Oench* line of cases is not so devastating to the approach taken below as might appear. As we noted recently in considering a related question—whether state or federal common law should supply the rule of decision for cases involving the construction of U.S. Postal Service leases—one choice for the federal common law judge is to adopt local law as the rule of decision. *Powers v. United States Postal Serv.*, 671 F.2d 1041, 1043 (7th Cir. 1982). That choice is attractive in the present case given the nature of the FDIC's claim.

The FDIC is suing as the assignee of the State Bank of Clearing's cause of action under state law against the defendants, and it is difficult to see why assignment to the FDIC should alter or enlarge that cause of action. *D'Oench*, though the Supreme Court refused in that case to follow state law, does not support such a metamorphosis. In *D'Oench* the FDIC had lent money to a bank that it had insured, and had received a note as collateral; and the question on which the Court refused to follow state law was whether the FDIC was a holder in due course, so that it could collect on the note free of the defenses that the payor might have had against the original payee. *D'Oench* was thus a case involving the rights of the United States in contracts to which it is a party, and is one of several cases all decided at about the same time that suggest that the rule of decision in such cases should be federal rather than state. See *Clearfield Trust Co. v. United States*, 318 U.S. 363, 367 (1943); *United States v. County of Allegheny*, 322 U.S. 174, 183 (1944); *Priebe & Sons, Inc. v. United States*, 332 U.S. 407, 411 (1947). Whatever the contemporary vitality of these cases—on which see *In re Murdock Machine & Engineering Co. of Utah*, 620 F.2d 767, 772 (10th Cir. 1980), and *Powers v. United States Postal Serv., supra*, 671 F.2d at 1045—they do not control the present case: it does not involve a contract to which the FDIC is a party.

True, the FDIC has a vital stake in any asset of a defunct bank that it has insured; the statute under which it operates contemplates the transfer of assets, presumably including causes of action, from such a bank to the FDIC, see 12 U.S.C. §§ 1823(d), (e); and *D'Oench* teaches that an asset can confer on its holder greater rights when it comes into the hands of the FDIC. These considerations, coupled with the language of section 1819 Fourth, suggest that in an appropriate case a federal court could reject state substantive law if that was necessary to protect the FDIC's interest in minimizing depositor losses which it must make good. But the absence of any ready-made federal common law in most of the areas of law in which it might be applied, and a general reluctance to displace state law without explicit statutory or constitutional direction to do so, support a presumption that state law is adequate and should be adopted by the federal court as the rule of decision. See *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 740 (1979); *Powers v. United States Postal Serv., supra*, 671 F.2d at 1045. The presumption is unrebutted here, so we can turn at last to the merits.

Braemoor Associates was formed in 1970 by several individuals, including Paul Bere, the president and board chairman of the State Bank of Clearing, to develop real estate. (Bere died before this suit was brought, and neither he nor his estate is a defendant.) Between 1970 and 1972 Bere caused the bank to make nine loans, totaling more than $500,000, to various of the joint venturers for use by Braemoor. These loans violated state law. Although it is not unlawful per se for an Illinois bank to make a loan to its officers, or to enterprises which the officers control or actively manage, such loans, if they exceed $10,000, as each of the nine loans did, require the approval of the bank's board of directors, see Illinois Banking Act, § 37(1), Ill. Rev. Stat. 1981, ch. 17, § 347(1), and implicitly therefore disclosure of the conflict of interest to the board. Since that disclosure was not made, the board's approval of these loans, an approval procured by fraud, was ineffective. However, all these loans were eventually repaid to the bank and are not in issue here.

Ringbloom, a real estate entrepreneur with whom Paul Bere had extensive business dealings, owned a company called Western. Bere and Ringbloom agreed that Western would purchase some land owned by Braemoor but the terms of payment were left somewhat indefinite. Late in 1971 Braemoor found itself owing a $60,000 installment payment to one of its contractors. Braemoor had less than $2000 in its bank account. Bere asked Ringbloom to pay Braemoor $60,000 on account of Western's land purchase so that Braemoor could pay the contractor, but Ringbloom said that Western did not have the money. Bere thereupon had the State Bank of Clearing lend Ringbloom $60,000 and Ringbloom immediately made out a check drawn on Western's bank account in the State Bank of Clearing for the same amount, payable to Braemoor. Ringbloom handed the check to Bere, who had it deposited in Braemoor's bank account. Braemoor then paid the contractor $60,000. The fact that the actual destination of the $60,000 loan from the State Bank of Clearing to Ringbloom was an enterprise controlled by Bere was not disclosed to the bank's board of directors. It is the first of the two loan transactions at issue in this case.

Several months later Braemoor needed to pay another installment to one of its contractors, this one for $240,000. Braemoor had only $16,000 in its bank account. Again Bere turned to Ringbloom, though Western was not due to make a payment to Braemoor on its land purchase agreement at that time. Again Western did not have the money, and again Bere stepped into the breach with a loan from his bank. This transaction was more intricate than the previous one. Bere had previously asked his brother, Lambert Bere, another of the joint venturers in Braemoor, to sign a note in blank payable to the State Bank of Clearing and to leave the note with him, Paul; and Lambert had done so. Paul now completed the note by making it out for $417,000, and directed the bank to lend this amount to Lambert. The money was deposited in a joint account maintained by Lambert and his wife at the State Bank of Clearing. A few days later Paul caused the entire amount to be transferred out of the account.

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The $240,000 payment to Braemoor is the second transaction at issue in this case. Lambert testified that he was stunned to receive his July 1972 bank statement showing a credit and offsetting debits for $417,000 and that he asked Paul about them but never received an explanation. The actual destination of the $417,000 loan was again not disclosed to the bank's board of directors.

The $60,000 loan to Western that found its way into Braemoor's pockets and the $240,000 portion of the second loan that also found its way into Braemoor's pockets were made in violation of Paul Bere's fiduciary obligations to his bank under section 37(1) of the Illinois Banking Act; and the question is whether this breach of trust may be imputed to Braemoor. If so, it is not disputed that the FDIC may recover the proceeds of the breach in the hands of Braemoor; and since the principles of partnership law apply to joint ventures of individuals, *Smith v. Metropolitan Sanitary District of Greater Chicago*, 77 Ill. 2d 313, 318, 396 N.E.2d 524, 527 (1979), there is also no question that if Braemoor is liable so are the individual defendants.

The district court found that the FDIC had failed to prove that the defendants had either (1) actual knowledge of Paul Bere's breach of trust or (2) knowledge of such facts as would lead a reasonable man to inquire whether Bere was committing a breach of trust; and the court concluded that without such proof the FDIC could not prevail. The FDIC does not challenge the finding that the defendants had no actual knowledge of the breach of trust, but it argues that the finding that they had no constructive notice is clearly erroneous and that in any event there are alternative grounds for recovering the monies sued for that have nothing to do with what the joint venturers, other than Paul Bere himself,

may have known, so that the district court's legal conclusion is incorrect even if none of its factfindings is.

We need not decide whether either factfinding is clearly erroneous. The FDIC's right to recover the proceeds of the two payments to Braemoor under the provisions of the Uniform Partnership Act (adopted in Illinois) is independent of what the other joint venturers knew, or as reasonable men should have known, about Paul Bere's breach of trust. Although the district court did not discuss the defendants' liability under the Uniform Partnership Act, the defendants do not contend that this theory of liability was not before the district court and should not be considered by us.

A joint venture of individuals is subject to the Uniform Partnership Act, *Mobil Oil Corp. v. Hurwitz*, 63 Ill. App. 3d 430, 380 N.E.2d 49 (1978), as indeed the Braemoor joint venture agreement expressly recites. Section 12 of the Act, Ill. Rev. Stat. 1981, ch. 106½, § 12, provides that "the knowledge of the partner acting in the particular matter, acquired while a partner or then present to his mind, . . . operate[s] as . . . knowledge of the partnership, except in the case of a fraud on the partnership committed by or with the consent of that partner." Paul Bere, a partner in Braemoor, knew that in funneling $300,000 of his bank's money to Braemoor through Ringbloom, Western, and Lambert Bere he was violating his fiduciary duty to the bank under section 37(1) of the Illinois Banking Act. Section 12 of the Uniform Partnership Act "imputed" that knowledge to the other joint venturers, which is to say made them and Braemoor, despite their lack of knowledge, fully liable for the breach of trust and hence constructive trustees of the proceeds of that breach for the benefit of the bank and its successor in interest, the FDIC, just as Paul Bere would have been if the FDIC had sued him. See *Howard v. Hamilton*, 28 N.C. App. 670, 675, 222 S.E.2d 913, 917 (1976). The exception in section 12 of the Uniform Partnership Act for frauds on the partnership is not applicable to this case, because Paul Bere was committing fraud on behalf of rather than against the partnership. Cf. *Maclay v. Kelsey-Seybold Clinic*,

456 S.W.2d 229, 234 (Tex. Civ. App. 1970), aff'd, 466 S.W.2d 716, 719 (Tex. 1971); *Cenco Inc. v. Seidman & Seidman*, 686 F.2d 449, 454-56 (7th Cir. 1982). We neither see, nor desire to concoct, any escape from the language of section 12. "The rule which imposes civil liability upon an 'innocent' partner for bad faith dealing of a co-partner is most pointedly applicable where the co-partner participates in the benefits derived from the dealing in bad faith." *Higgins v. Shenango Pottery Co.*, 256 F.2d 504, 509 (3d Cir. 1958), construing an identically worded predecessor provision to section 12.

We reach the same conclusion by an alternative route. Section 13 of the Uniform Partnership Act, Ill. Rev. Stat. 1981, ch. 106½, § 13, provides that "where, by any wrongful act or omission of any partner acting in the ordinary course of the business of the partnership, or with the authority of his co-partners, loss or injury is caused to any person, not being a partner in the partnership, . . . the partnership is liable therefor to the same extent as the partner so acting or omitting to act." There is no doubt that Paul Bere's violation of section 37(1) of the Illinois Banking Act caused an injury to the bank (and hence to its successor in interest, the FDIC), so that Braemoor is liable if Bere was acting either "in the ordinary course of [Braemoor's] business" or "with the authority of" the other joint venturers; and we think he was doing both. The nine loans made at Paul Bere's direction by the State Bank of Clearing to the individual joint venturers for the benefit of Braemoor show that Bere was acting in the ordinary course of Braemoor's business when he channeled bank money to Braemoor in violation of the Illinois Banking Act. This is perfectly clear with respect to the nine loans themselves and scarcely less so with respect to the two loans in issue here. The fact that the money went from the bank to Braemoor through Ringbloom and Western, or as in the second transaction through Ringbloom, Western, and Lambert Bere, rather than directly, is a detail. They were transactions, "laundered" transactions to be sure, by which Paul channeled the bank's money to Braemoor; and the financing of Braemoor by the bank had become the ordinary course of business for Brae-

moor. Cf. *Zemelman v. Boston Ins. Co.*, 4 Cal. App. 3d 15, 84 Cal. Rptr. 206 (1970).

We also think his partners authorized Paul Bere to channel bank money to Braemoor. They knew, from the eight of the nine loans that predated the two loans in issue, that Bere was channeling money from his bank to Braemoor, and they obviously approved, and thereby authorized, his doing so. We can imagine no theory under which Paul Bere was authorized to borrow upwards of $500,000 from the bank directly for Braemoor but not to borrow additional sums indirectly, through Ringbloom and Western. Why should his co-venturers have cared what route the money followed from its source? This is not to say that the actual violation of the Illinois Banking Act was authorized; we accept the district court's finding that the other venturers did not know of any such violation. But section 13 of the Uniform Partnership Act requires only that the partner who commits the wrong be acting with the authorization of his partners when he does so—not that the violation itself be authorized, see *Elle v. Babbitt*, 488 P.2d 440, 446-47 (Ore. 1971)—and Paul Bere was acting with that authorization when he committed the violation; he was not off on some frolic of his own. As for the district court's finding that "the defendants did not impliedly delegate to Paul the authority to arrange financing for the purchase of the Braemoor properties," we do not understand its relevance. The loans in issue were not for the purchase of any properties; they were for a street and sewer system on property already owned by Braemoor.

There is nothing novel or exotic about the principles embodied in sections 12 and 13 of the Uniform Partnership Act or their application to the facts of this case. The two sections, section 13 especially, merely extend to partnerships familiar principles of agency law, among them the principle of *respondeat superior*, whereby an employer is liable for the torts of his employees committed in the course of their employment. The extension of this principle to partnerships antedates the Uniform Partnership Act. See *Hamlyn v. John Houston & Co.*, 1903

L.R. 1 K.B. 81 (C.A. 1902). The district court erred by limiting its analysis to the distinct principles that govern cases where property that has been obtained in breach of trust comes into the hands of a third party who is not the principal or agent or partner of the person who committed the breach or is otherwise linked to him by a preexisting relationship, but is a stranger, and the question is whether the stranger has sufficient notice of the breach of trust to be forced to disgorge the property. See *Kurowski v. Burch*, 8 Ill. App. 3d 716, 720, 290 N.E.2d 401, 405 (1972), aff'd, 57 Ill. 2d 292, 312 N.E.2d 284 (1974); Restatement of Restitution § 168(2) (1937); 4 Scott, The Law of Trusts §§ 296-97 (3d ed. 1967). The law imposes greater duties on people with regard to the acts of their agents and partners than with regard to the acts of strangers, presumably to give people an incentive to choose carefully with whom to enter into ventures that may injure innocent third parties.

So we need not consider whether the district court, treating this as if it were a case where the breaching trustee and the constructive trustee were strangers rather than partners, was correct in concluding as a matter of fact that the joint venturers lacked knowledge of such facts as would have led reasonable men to inquire further into whether Paul Bere was committing a breach of trust—though we shall not conceal our skepticism that Lambert Bere did all that a reasonable man should have done to inquire into the circumstances whereby $417,000 passed mysteriously in and out of his bank account in a space of days. The liability of the joint venturers under the Uniform Partnership Act is independent of their knowledge—whether actual or, under general principles of restitution, constructive—of Paul Bere's breach of trust.

The FDIC has still another theory of liability—that the defendants conspired with Paul Bere to commit a breach of trust against the bank. The district court rejected this theory on the facts, finding that the FDIC had failed to prove that the defendants actually knew of Bere's breach of trust. This finding is at least plausible;

although they knew he was borrowing money from the bank for his joint venture his borrowing would not have been a breach of trust had Bere gotten the informed consent of his board of directors, a matter about which the defendants could not be presumed to know. At any rate we cannot say that the district court's finding was clearly erroneous, so we affirm this part of its judgment. However, the rejection of the FDIC's theory of liability under the Uniform Partnership Act was erroneous, and the judgment dismissing the complaint must therefore be reversed and the case remanded for further proceedings consistent with this opinion.

So ORDERED.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

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No. 82-1258

In the Supreme Court of the United States

OCTOBER TERM, 1982

BRAEMOOR ASSOCIATES, ET AL., PETITIONERS

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly concluded that, as a matter of state law, a breach of fiduciary duty by one partner could be imputed to other partners in a joint venture.

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v.

Federal Deposit Insurance Corporation

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 20-32) is reported at 686 F.2d 550; the amended opinion of the court of appeals (Pet. App. 33-45) is not yet reported. The opinion of the district court (Pet. App. 1-19) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on August 13, 1982. A petition for rehearing was denied, and the court's opinion amended, on October 28, 1982 (Pet. App. 33). The petition for a writ of certiorari was filed on January 26, 1983. The jurisdiction of this court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 13 of the Illinois Uniform Partnership Act (Ill. Rev. Stat. ch. 106-1/2, (1981) provides:

> Where, by any wrongful act or omission of any partner acting in the ordinary course of the business of

> the partnership, or with the authority of his co-partners, loss or injury is caused to any person, not being a partner in the partnership, or any penalty is incurred, the partnership is liable therefor to the same extent as the partner so acting or omitting to act.

Section 12 of the Illinois Uniform Partnership Act (Ill. Rev. Stat. ch. 106-1/2 (1981) provides:

> Notice to any partner of any matter relating to partnership affairs, and the knowledge of the partner acting in the particular matter, acquired while a partner or then present to his mind, and the knowledge of any other partner who reasonably could and should have communicated it to the acting partner, operate as notice to or knowledge of the partnership, except in the case of a fraud on the partnership committed by or with the consent of that partner.

STATEMENT

1. In 1975 the Illinois Commissioner of Banks and Trust Companies took possession and control of the State Bank of Clearing in Chicago and appointed the Federal Deposit Insurance Corporation ("FDIC") as receiver (Pet. App. 2). The FDIC subsequently commenced this action in the United States District Court for the Northern District of Illinois to recover bank funds that Paul Bere,[1] the bank's president and chairman of the board, had funneled to a joint venture in which he had a financial interest.

The joint venture, petitioner Braemoor Associates ("Braemoor"), was formed in 1970 as a vehicle for real estate development (Pet. App. 38). The partners in Braemoor were Paul Bere and petitioners Hulse, Bennett, Kaye,

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[1]Paul Bere died on July 26, 1974 (Pet. App. 2); neither he nor his estate is a defendant in this case.

Jousma, and Lambert Bere (*id.* at 5).[2] Between 1970 and 1972 Paul Bere unlawfully transferred more than $800,000 from the State Bank of Clearing to Braemoor. As the court of appeals noted (*id.* at 38), those transactions were unlawful under Illinois state law because Paul Bere did not disclose his financial interest in Braemoor to the bank's board of directors.

Of that total of approximately $800,000, some $300,000 is at issue in this case.[3] These funds were diverted from the State Bank of Clearing in two transactions. While the specifics of each transaction differed, they were similar in several respects. In both instances, Braemoor faced financial obligations it lacked the cash to pay. In both instances, Paul Bere asked one Kenneth Ringbloom to make payments to Braemoor in the amounts Braemoor owed to others; both times, Ringbloom lacked funds to make the payments. Paul Bere arranged for the State Bank of Clearing in both instances to extend loans to Ringbloom; Ringbloom then forwarded the money to Braemoor, which paid its creditors. In neither instance did Paul Bere disclose to the bank's board of directors that he had an interest in Braemoor, the ultimate beneficiary of the transfers.

a. The first transaction, involving $60,000, occurred in 1971. At that time Braemoor had less than $2,000 in its bank account and owed a contractor a $60,000 installment payment on a total obligation of $230,000 (Pet. App. 7, 9, 39). To make this payment, Paul Bere asked Ringbloom to

[2] Lambert Bere was Paul Bere's brother. He became a vice-president and director of the State Bank of Clearing after the events at issue (Pet. App. 2, 26).

[3] The remainder of the illegal transactions, nine loans to individual Braemoor partners aggregating more than $500,000, were repaid and are not the subject of these proceedings (Pet. App. 38).

forward $60,000 on account to Braemoor (*id.* at 39).[4] When Ringbloom replied that he did not have the money, Paul Bere arranged for the State Bank of Clearing to make a loan in that amount (*ibid.*). Ringbloom immediately paid Braemoor $60,000 and Braemoor met its installment payment to the contractor (*ibid.*). As in the case of earlier loans to the Braemoor partners (see note 3, *supra*), Paul Bere did not disclose his interest in Braemoor to the bank's board of directors (Pet. App. 38).[5]

b. The second transaction in issue occurred in July 1972, when Braemoor needed to make an installment payment of $240,000 to another contractor.[6] Braemoor's checking account balance at this time was less than $16,000 (Pet. App. 39; Pltff. Exh. 2). Paul Bere again arranged for funds

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[4]Ringbloom had previously entered into an oral agreement with Paul Bere for Ringbloom's company, Western Land Planning Company ("Western") to purchase land from Braemoor (Pet. App. 39). Ringbloom testified at trial that no payment dates were specified in that oral agreement (Tr. 56, 59). The district court found that Western would not have paid $60,000 to Braemoor if the bank had not made this loan (Pet. App. 9).

[5]On July 14, 1972, following an audit of the State Bank of Clearing by state and federal bank examiners, Paul Bere arranged for the Marquette National Bank to loan $800,000 to Ringbloom and his company (Western) for ten days. This loan was designed to repay the $60,000 loan that found its way to Braemoor, as well as other debts Ringbloom and Western owed to the State Bank of Clearing. In order to secure this loan, Paul Bere gave Marquette written assurance that the State Bank of Clearing would, within ten days, again loan Ringbloom the full amount needed to repay Marquette. Ten days later, the State Bank of Clearing did so; Marquette was paid and, at the time the State Bank of Clearing was closed, $780,000 was outstanding on the final loans to Ringbloom. In this proceeding, FDIC is attempting to recover the $60,000 of that amount that was received by Braemoor. Pet. App. 9-10; Tr. 65-69.

[6]The contractor, Seneca Petroleum Company, was owned by petitioner Hulse (Pet. App. 6, 12; Tr. 114).

to be paid by the State Bank of Clearing, through Ringbloom, to Braemoor, but through a more circuitous route than he used in the earlier transaction (Pet. App. 39). Using a blank note he had previously asked his brother Lambert to sign for "our personal business, family business" (Tr. 222), Paul Bere caused the State Bank of Clearing to lend $417,000 to Lambert. At Paul Bere's direction, this amount was deposited in Lambert's checking account and, several days later, was transferred out of that account (Pet. App. 39).[7] Of this total, $250,000 was deposited in a checking account maintained by Ringbloom's company; that company immediately issued a $240,000 check to Braemoor (Pet. App. 40).[8] Again, Paul Bere did not disclose his interest in these transactions to the bank's board of directors.

2. The district court found that the Braemoor partners had no actual knowledge of Paul Bere's breach of trust nor did they have sufficient facts to alert a reasonable person to inquire further (Pet. App. 16). Accordingly, the court granted petitioners' motion to dismiss the complaint at the close of respondent's presentation of evidence.

The court of appeals reversed. It held that petitioners' liability does not turn on whether they knew, or should have known, of Paul Bere's breach of trust. Under the Uniform

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[7]At the time, Lambert had no outstanding debt to Western (Pet. App. 13). When Lambert received his monthly statement, he was "stunned" (Pet. App. 40) to see this swing of $417,000, but never received an explanation from his brother. *Ibid.*; Tr. 202-206, 209, 236.

[8]Paul Bere caused these loans to be refinanced through an additional series of loans involving accounts held by his brother and by several companies owned by Ringbloom (Pet. App. 13-14). The result at the end of this trail is that the funds the FDIC seeks to recover from Braemoor remain unpaid (*id.* at 14). In 1975, several of Ringbloom's companies filed Chapter XI bankruptcy proceedings. Stip. 3, 8 ("Stip." refers to the Stipulation of Uncontested Facts, Exhibit A to the Final Pretrial Order in the district court, July 30, 1979).

Partnership Act, as adopted by Illinois, Paul Bere's illegal acts are imputed to his partners and they are "constructive trustees of that breach for the benefit of the bank and its successor in interest, the FDIC, just as Paul Bere would have been * * *" (Pet. App. 41). Moreover, under Section 13 of the Uniform Partnership Act, Ill. Rev. Stat. ch. 106-1/2 (1981), the partners are liable for actions taken by Paul Bere in the ordinary course of Braemoor's business. Pet. App. 42. "The fact that the money went from the bank to Braemoor through Ringbloom and Western, or as in the second transaction through Ringbloom, Western, and Lambert Bere, rather than directly is a detail. They were transactions, 'laundered' transactions to be sure, by which Paul [Bere] channeled the bank's money to Braemoor * * *." *Ibid.*

ARGUMENT

The court of appeals carefully considered and correctly decided the issues presented. Its decision, which is based on state law, does not conflict with any decisions of this Court or of any other court of appeals. Accordingly, the case does not warrant further review.

1. Petitioners mount a two-pronged attack on the decision below (Pet. 11-12, 15-16): first, that the court of appeals relied upon a legal theory under state law that had not been presented to the trial court; and, second, that the court misapplied state law. Neither contention warrants this Court's review.

a. The court's citation (Pet. App. 29) of Section 37 of the Illinois Banking Act, Ill. Rev. Stat. ch. 17, § 347 (1981) (requiring board of directors' approval for loans to bank officers) did not inject a new legal principle into the case. From the outset, the FDIC has based its claim on Paul Bere's breach of his fiduciary duty when he caused the State Bank of Clearing to make loans for the benefit of Braemoor

without informing the bank's board of directors of his financial interest in the venture. Petitioners have never disputed the fact that this conduct constituted a breach of that duty, and the district court expressly referred to "Paul's breach of trust" (Pet. App. 16, 17).

The FDIC's main brief in the court of appeals cited several cases in support of the principle that a bank officer breaches his fiduciary duty by making loans to ventures in which he has a personal financial interest without disclosing that interest to the board of directors. (See, *e.g.*, *Shlensky* v. *So. Parkway Bldg. Corp.*, 19 Ill. 2d 268, 166 N.E.2d 793, 799 (1960); *Karris* v. *Water Tower Trust & Savings Bank*, 72 Ill. App.3d 339, 353, 389 N.E.2d 1359, 1369 (1979); *Maryland Casualty Co.* v. *American Trust Co.*, 71 F.2d 137, 138 (5th Cir. 1934); *Tcherepnin* v. *Franz*, 316 F. Supp. 714, 720 (N.D. Ill. 1970), aff'd in part and appeal dismissed in part, 485 F.2d 1251, 1256 (7th Cir. 1973).) Petitioners did not dispute, or even discuss, any of those cases. The court of appeals merely cited the Illinois Banking Act, rather than case law, as authority for the same fiduciary duty.[9]

b. Similarly without merit is petitioners' contention (Pet. 12) that the court of appeals incorrectly applied Illinois State law. As the court of appeals found, it is well established that such non-disclosure of interest is a violation of a bank officer's duty. In similar circumstances, this Court has deferred to decisions of the courts of appeals and the district

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[9]Because the issue decided by the court of appeals had in fact been raised in the district court, the cases petitioners' cite (Pet. 15) are inapposite. In *Singleton* v. *Wulff*, 428 U.S. 106, 121 (1976), the district court had granted a motion to dismiss on the ground that the plaintiff lacked standing to sue; the court did not consider the question whether the underlying statute was valid. The court of appeals held the statute to be valid. This Court reversed because the plaintiff did not have an opportunity to present evidence essential to determine the statute's validity. Similarly, in *Journey* v. *Vitek*, 685 F.2d 239, 243 (8th Cir. 1982), an issue had not been raised in the district court.

courts applying the laws of the states within their jurisdiction. *E.g., Bishop* v. *Wood*, 426 U.S. 341, 346 & n.10 (1976); *Butner* v. *United States*, 440 U.S. 48, 58 (1979). At all events, the state law issue presented does not warrant review by this Court.

2. Petitioners' remaining contentions relate to fact-bound issues of no general importance that do not warrant further review.

a. Petitioners are incorrect in claiming (Pet. 14) that the court of appeals "substituted its own 'off-the-wall' findings of fact" for the district court's finding that petitioners had no actual or constructive knowledge of the two loan transactions in issue. The district court made no findings whatever on the question whether petitioners could be charged under general principles of partnership law with imputed knowledge of the wrongful acts.[10] The court of appeals, therefore, did not substitute findings for those of the district court; the court of appeals simply concluded as a matter of law that Paul Bere's knowledge of his own wrongdoing was imputed to his partners under Sections 12 and 13 of the Uniform Partnership Act.

b. Petitioners contend (Pet. 6, 7, 13) that the loans in issue have been repaid. This claim is based on paragraphs 26.4 and 38.6 of the stipulations in the district court (see note 8, *supra*). Stipulation 26.4 provides that "[t]he loan ledger of the State Bank of Clearing contains an entry stating that the $60,000 loan was repaid on July 14, 1972." But this is not the entirety of the relevant stipulation; it continues, and states that "the parties do not agree as to whether this loan was in fact repaid on July 14, 1972, or was

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[10]This issue had been presented to the district court both in the Final Pretrial Order, Exh. D, paras. 14-15, and in the FDIC's Proposed Findings of Fact and Conclusions of Law in the supplemental record filed in the court of appeals on Sept. 17, 1982.

refinanced through the series of transactions set forth in * * *. This loan is the subject of this litigation."[11] There is, therefore, no need further to review the conclusion of the court of appeals with respect to this issue.

c. Petitioners argue (Pet. 12) that the court of appeals' decision disregards the district court's finding (Pet. App. 16) that " '[t]he loan transactions at issue were made for the purchase of property (by Ringbloom) rather than as a device for the purpose of financing the Braemoor partnership.' " The court of appeals, however, unlike the district court, did not comment on *Ringbloom's* reasons for obtaining the loans; rather, the Seventh Circuit properly looked at the totality of the " 'laundered' transactions * * * by which Paul [Bere] channeled the bank's money to Braemoor." Pet. App. 42. In any event, the court of appeals did not "disregard" the trial court's finding, it merely noted (*ibid.*), the finding was irrelevant to the correct legal analysis.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

REX E. LEE
Solicitor General

THOMAS A. BROOKS
General Counsel
Federal Deposit Insurance Corporation

APRIL 1983

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[11]Stipulation 38.6 is to a similar effect.

No. 82-1258

In the

Supreme Court of the United States

BRAEMOOR ASSOCIATES, a joint venture, and LAMBERT BERE, JR., OWEN HULSE, JR., CHARLES M. BENNETT, GEORGE JOUSMA, and WILLIAM J. KAYE, individually and as joint ventures doing business as Braemoor Associates,

Petitioners,

vs.

FEDERAL DEPOSIT INSURANCE CORPORATION,

Respondent.

PETITIONER'S REPLY TO BRIEF FOR RESPONDENT IN OPPOSITION

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APRIL 28, 1983

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IN THE SUPREME COURT OF THE UNITED STATES

BRAEMOOR ASSOCIATES, ET AL., *Petitioners*,

vs.

FEDERAL DEPOSIT INSURANCE CORPORATION, *Respondent*.

PETITIONER'S REPLY TO BRIEF FOR RESPONDENT IN OPPOSITION

ARGUMENT

The Federal Deposit Insurance Corporation ("FDIC") in its brief in opposition mischaracterizes the attack of the Petitioners as well as mischaracterizes the evidence and the district court fact finding. The court of appeals set aside fact findings of the district court Judge without finding them clearly erroneous in derogation of Rule 52 of the Federal Rules of Civil Procedure and decided the appeal on law not argued in the district court. Further, the separate question remains as to the conflict of circuits as to the circumstances when a theory of law may be presented to the Court of Appeals when it was not argued below.

The FDIC on page 7 of its brief cites several cases it relied on *in the Seventh Circuit* and in a footnote on that page states that these cases had been raised in the district court. However, these cases were *not* cited by

the FDIC in any district court pleadings that are a part of the record on appeal. The FDIC maintains that these cases placed before the court are authority for the fiduciary duties of Paul Bere and are a basis of liability in this case. The liability that the FDIC seeks to impose on defendants in this case is *per se* liability due to Paul Bere's acts with regard to two loans. However, the Seventh Circuit clearly states that "it is not unlawful per se for an Illinois Bank to make a loan to its officers, or to enterprises which the officers control or actively manage". (Pet. App. p. 38). It is only due to the Section 37(1) of the Illinois Banking Act, Ill. Rev. Stat. 1981, Ch. 17, § 347(1) that such loans if they exceed $10,000 must be brought before the bank's board of directors, Thus, if there was an impropriety by Paul Bere as to the loans at issue, that impropriety was not due to case law, it is rather due only to the provision of the Illinois Banking Act, and the FDIC failed to ever mention that act orally or by pleading in the district court, failed to ever mention that act in its court of appeals briefs or in oral argument to the court of appeals, and did not even rely on that act in response to defendant's petition for rehearing in the court of appeals. That foundation block upon which the court of appeal's decision is based was not placed before the district court and was not placed before the court of appeals by any party as authoirty for a decision.

In fact the FDIC did not even rely on the partnership statutes it cites in its brief in opposition in its presentations to the district court on brief after the conclusion of its case. The FDIC lightly and in a general sense mentioned some partnership law in its pretrial order and in it *pretrial* submission of proposed findings of fact and conclusions of law. But partnership law was not the

basis of the FDIC's contentions of defendant's liability in its brief after the conclusion of its case. The FDIC chose to rely on other principles. The FDIC brief after the conclusion of its case is divided into four parts. The first part states background facts. Another part argues the conspiracy theory that was rejected both by the district court and by the court of appeals. A third part argues liability based on a theory of defendants' liability based on Paul Bere's "express or implied authority" from defendants. At paragraphs 67 and 68 of the district court's findings (Pet. App. 16) the district court found that there was no such express or implied authority, and that finding is not stated to be clearly erroneous by the Seventh Circuit. The last theory argued by the FDIC after the trial was a theory of "constructive knowledge" based on the theory that defendants are charged with constructive knowledge and are liable as constructive trustees because they knew that Paul Bere was a fiduciary of the bank and knew that every circumstance relating to their transactions with Paul and the bank was "so extraordinary" that they were under a duty to investigate and were liable for failure to investigate because such investigation would have made them knowledgable as to Paul's breach. The FDIC's constructive trustee argument in the FDIC district court brief is attached hereto so that this Court can see the limited extent of the FDIC argument to the district court. And the district court responded to that argument, as it responded to the other arguments that the FDIC made to it. At paragraph 66 of its findings of fact (Pet. App. 16) the district court judge found that "The circumstances of the financial transactions between defendants and Paul were *not* so extraordinary that the defendants should

have known of Paul's breach of trust nor were the defendants in possession of such facts sufficient to alert a reasonable person to inquire whether Paul was breaching his trust".

The FDIC on page 8 of its brief in opposition is critical of the district court judge for making no findings whatsoever on the question whether petitioners could be charged under general principles of partnership law with imputed knowledge of wrongful acts. While briefly mentioning partnership law in pretrial submissions including a *pretrial* submission of proposed findings of fact and conclusions of law, the FDIC chose to rely only on three *other* theories of liability after is closed its case and the district court squarely responded to those three theories in the opinion. The district court judge was not required to go beyond what was finally relied upon by the parties. He is not required to search for other theories in the adversary proceeding. The trial court, having no opportunity of passing upon the issue now relied on, cannot be charged with error in failing to do what it was not requested to do. *Gilby* v. *Travelers Ins. Co.*, 248 F. 2d 794 at 797 (8th Cir., 1957).

Separately, the court of appeals usurped the fact finding function of the district court in changing the facts found by the district court without finding them clearly erroneous and with no basis making them support the new partnership theories raised in the court of appeals. Though the issue of the two sections of partnership law relied on by the FDIC was not finally relied on by the FDIC in the district court, the district court's findings of fact preclude the application of either section to this case.

Regarding section 13 of the Uniform Partnership Act (Ill. Rev. Stat. ch. 106½), that section by its terms does not apply unless the partner involved either is (1) acting in the ordinary course of business of the partnership or (2) with the authority of his copartners. Ringbloom was purchasing two parcels of real estate from Braemoor with the money involved in the two loans at issue. (Tr. 147-149, 106-107, 156-157). The district court in dealing with all transactions in the case, at findings of fact, paragraph 69, held that the loan transaction at issue was made to aid Rightbloom in the purchase of that property rather than as a device for the purpose of financing (or laundering money for) the Braemoor partnership (Pet. App. 16). Thus, the district court found that the loan transactions did not have as their purpose doing something for the business of Braemoor and thus clearly the element of Paul's act being in the ordinary course of Braemoor's business is absent. Secondly, the District Court found at paragraphs 67 and 68 of its findings (Pet. App. 16) that Paul Bere was not so acting with express or implied authority of his copartners. Thus, section 13 of the Uniform Partnership Act cannot be applied to create liability as to defendants.

Similarly, Section 12 of the Uniform Partnership Act (Ill. Rev. Stat. ch. 106½) also cannot be so applied. By its terms the matter involved must relate to partnership affairs before that section is applicable. As just stated, the district court found that the loan was for Ringbloom to purchase property and not to finance or launder money to Braemoor. Therefore, what is involved is not a matter relating to Braemoor partnership affairs and Section 12 cannot be applied to create liability as to Braemoor and its other partners. In addition, an ex-

ception to Section 12 exists where the partner involved in the action is committing fraud on the partnership. In the $240,000 loan transaction, Paul Bere who arranged the loan was a 50% partner of the borrower who was purchasing from Braemoor and that fact was unknown to the defendants so that Paul Bere was using the loan transaction to secretly gain a 50% interest in the land in which he had previously had a 16⅔% interest. (Pl. Ex. 1, tr. 147, 153). Paul arranged the sale from Braemoor so he could secretly be a purchaser and that is not only acting outside the Braemoor partnership affairs, that is committing fraud on Braemoor. Thus, we have two reasons based on the clear language of Section 12 of the Uniform Partnership Act as to why that section does not apply to this case and each reason is independent of the other. Further, *Rowely Law of Partnership,* 2nd Ed., Volume 1, section 12.2 supports what is stated here.

Though the court of appeals opinion does not hold that the district court findings of facts which negate the application of the Uniform Partnership Act were clearly erroneous, it will be shown that those findings of fact were clearly based on the evidence and that evidence is in fact not as characterized by the FDIC in its brief in opposition.

The District Court found defendants' testimony to be credible at finding of fact paragraph 62 (Pet. App. 15). Defendants testified that Paul's action on the loans was not within his authority and the district court so found. (Tr. 269-270, 290, 314-315). Further, the district court found at paragraph 71 of its findings of fact that at the time of the transactions at issue, the defendants, both

in their individual capacities and as a partnership, had sufficient sources of credit other than the State Bank of Clearing to meet their obligations as they became due (Pet. App. 16). Petitioners were thus not under the pressure to get the money from the State Bank of Clearing as implied in the FDIC brief in opposition. In fact, Petitioners were not under pressure in either of the two transactions that were paid with proceeds from the two land sales to Ringbloom. Regarding the $60,000 payment on the water tower, though that payment was due, there was a 15-day cure section in the contract after written notice of default, there was no written notice of default; if such a notice was received petitioners had a $700.000-$800,000 line of credit at the Chicago City Bank where at the time they had paid a $500,000 loan down to $325,000 and they could easily have obtained money for the $60,000 payment if they needed it, and further, the person due that money did not consider the contract in default, but rather wrote, as is stipulated, that "the entire sale and conclusion of the transaction was handled in a first class business-like manner, with no troubles or problems encountered along the way" (Stipulation par. 21.4, Tr. 135, 136, 145, 134, 187). As to the $240,000 transaction, the company which was owed the money was owed $440,000 and had not demanded payment of that sum, but was instead financing Braemoor. (Tr. 133, 134, 144, 262). Again as stated above, had petitioners needed the money, they had the sources to get it from which were other than Paul Bere's bank. It also must be noted that the FDIC claims that Ringbloom could not have made the payment without the $240,000. However, the stipulation does not show cash problems for the Ringbloom company involved.

Paragraph 39.2 of the stipulation of facts of the parties shows that from the date Ringbloom's company wrote the $240,000 check to the date that check cleared that company's account, over $800,000 cleared that account.

What Paul Bere did was clearly for Ringbloom. The $60,000 and the $240,000 helped Ringbloom to acquire property for development. Ringbloom was a favored customer of the bank where he and his entities were permitted regularly to have overdrafts in their checking accounts of tens of thousands of dollars and were given loans which exceeded four and a half million dollars when the bank's lending limit was about $500,000. (Stipulation par. 3.5.2, 3.6, 3.7 and schedules A, B, and C thereto, tr. 42). Ringbloom's success with acquiring such property should have aided his paying back that indebtedness which was in Paul's interest. Further, as stated, the $240,000 loan enabled not only Ringbloom to acquire the property, but enabled Paul Bere to secretly obtain a 50% ownership in the acquired property. Thus, the breaches by Paul were for Ringbloom's benefit and for Paul's own benefit and Braemoor's property sale was a means to that benefit. All of this solidly supports the district court's finding that the loans were not designed for petitioners Braemoor's benefit. The loans were not to launder money for Braemoor.

It is also noted, though it is merely a bonus for Petitioner's lack of liability, that the stipulation shows the $240,000 taken on Paul's filling out of Lambert's blank note was, as is stipulated, repaid to the bank within 21 days by loans taken out by Albany Supply Co., Ringbloom Construction Co., and possibly by Indian Trails Apartments and the $60,000 was repaid to the bank in

the $400,000 loan to Ringbloom from the Marquette Bank which was repaid by $335,000 and portions of a $465,000 loan to Ringbloom and Western Construction Company. (Stip. par. 29.2, 29.41, 41.1, 41.2, 41.3, 42, 42.1). There is absolutely no evidence that petitioners were involved in those transactions and they were not so involved (Entire Record).

The FDIC states in its brief in opposition that the court of appeals carefully decided and correctly decided the issues presented. It should be obvious that this is incorrect. The entire first opinion of the court of appeals was based on the assumption that the board of directors of the bank had not approved the loans in question whereas paragraph 55 of the stipulation of the parties clearly stated otherwise. That is but one instance of the court of appeals ignoring the record and tailoring the facts to the desired opinion and the amended opinion continued that disregard of the record and of the function of the district court judge. The assertion by the court of appeals that petitioners were under pressure to pay creditors and that the loans were really methods of laundering money to get it to petitioners to pay the debts is contrary to the record and to the findings of the district court and is done without any finding or possibility of a finding that the district court findings were clearly erroneous as required by Rule 52 of the Federal Rules of Civil Procedure. And the District Court findings were based on the totality of the transactions. The district court knew the money eventually went to Braemoor in exchange for property, but held that the purpose of the transaction was not to finance Braemoor, but was to finance Ringbloom. The supervisory power of the United States Supreme Court is properly invoked because "It is

not enough that we (the Supreme Court or an appellate court) might give the facts another construction, resolve the ambiguities differently, and find a more sinister cast to actions which the district court deemed innocent. We are not given those choices because our mandate is not to set aside findings of fact 'unless clearly erroneous'". *United States* v. *Real Estate Board,* 339 U.S. 485 at 495-6.

CONCLUSION

The exercise of the supervisory power of this Court is most important for the integrity of the court system and it is also important at this time when this Court is asking Congress for aid as to congestion. That supervision should reduce writs to this Court and will send a message that the courts of appeal are not the place for de novo litigating and will protect and encourage the conscientious exercise of the trial function by the district court judges as well as do justice in this case. For reasons stated herein and in the Petition, the writ of certiorari should be granted.

Respectfully submitted,

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April 28, 1983

REPLY BRIEF APPENDIX

PORTION OF FDIC DISTRICT COURT BRIEF

III. DEFENDANTS' CONSTRUCTIVE KNOWLEDGE

Even if it is assumed arguendo that Paul had neither express nor implied authority to obtain the two loans in question on behalf of the venture, the defendants are nonetheless liable on the ground that they had constructive knowledge of Paul's breach of his fiduciary duties to the bank and the use of those loan proceeds for the benefit of Braemoor Associates. Plaintiff's Pre-Trial Brief cites a number of cases (on pages 8-19) which support plaintiff's claim that the defendants are charged with constructive knowledge and are liable as constructive trustees. Without repeating all that was said there, we want to call attention in particular to the case of *Higgins* v. *Shenango Pottery Company*, 256 F.2d 504, 510 (3rd Cir. 1958), which is discussed on pages 13-14 of our Pre-Trial Brief.

In the *Higgins* case, a partnership was composed of certain corporate officers and the three defendants who were not employees of the corporation. The officer-partners diverted corporate business to the partnership. In holding the three non-employee defendants liable as constructive trustees, the Court used language which is applicable to the defendants in this case:

> "There is enough in the proofs from which it may be inferred that they knew or should have known that the Castle scheme [the partnership business] was contrary to the best interests of Shenango [the corporation]; that *every circumstance relating to the transaction was so extraordinary* that these men, partners in Castle, could not stand by and avoid even a simple inquiry; that dealing as they were with these Shenango fiduciaries, knowing who they were and therefore, what they were, Pfau, McCarty

> and Shumaker were bound to *ascertain whether their partners were violating their trust*; that because they were chargeable with knowledge of the breach, or at least with the compelling duty of inquiry, they must make restitution for the benefits they have realized as a consequence of the breach of trust." (256 F.2d at 510, Emphasis added)

Similarly, the Braemoor defendants knew that Paul was a fiduciary of the Bank and knew that "every circumstance" relating to their transactions with Paul and the Bank was "so extraordinary" that they were under a duty to investigate. A diligent inquiry would have disclosed Paul's breach and the use of the loan proceeds for the defendants' benefit.

The extraordinary circumstances known to the defendants included their knowledge of Paul's conduct in arranging the 19 loans discussed at pages 9-12, supra, all of which Paul had caused the Bank to make nominally to the individual partners for the real benefit of Braemoor or some other venture in which Paul and the defendants were personally interested. The defendants were well aware of Paul's fiduciary relationship to the Bank, his conflict of interest and his personal benefit from all of the loans which were made to the defendants. The defendants cooperated with Paul in an on-going scheme to conceal from the bank Paul's secret interest, his breaches of trust, and the identity of the true beneficiaries of the loans.

In addition, the defendants knew that Ringbloom was a contractor; and at least some of the defendants were aware that Ringbloom was a customer of the Bank and assumed that he borrowed from the bank, although they did not know the specific amount of any loans. (Tr. 104, 113, 250-1, 286, 304) The defendants also knew, or certainly should have known, that Paul would have a conflict of interest and would violate his fiduciary duties to the Bank if he caused the bank to finance Braemoor's sale of its land whether to Ringbloom or to anyone else.

The defendants' knowledge of all the foregoing facts was itself sufficient to put the defendants on inquiry to determine whether Paul had financed Ringbloom's purchase of Braemoor property by making loans from the State Bank of Clearing. Over and beyond such general knowledge, however, Lambert and Bennett knew the extraordinary circumstances surrounding the $417,567.71 loan transaction in July 1972.

Lambert received a personal checking account statement from the State Bank of Clearing in early August 1972 showing an unexpected credit of $417,567.71 and two offsetting debits of $167,567.71 and $250,000. (Stip. ¶¶38-38.3 and PX 35) Lambert asked Paul for an explanation, but never got a satisfactory answer, or an answer he could understand. (Tr. 203-204) According to Lambert, he was only told the obvious — that the money went in and out. (Tr. 204) The defendants erroneously claim in paragraph 13 on page 10 of their Post-Trial Suggested Findings of Fact that Lambert ". . . asked his brother Paul Bere for an explanation and got none and had thought it was a clerical error (Tr. 219-220, 222)." This is not entirely correct. Reference to the cited pages and also pages 203, 206 and 236 of the Transcript shows that Lambert's "first reaction" was to think the entries were a clerical error *before* he talked with Paul. (Tr. 203) After talking with Paul, Lambert knew that there was no clerical error and knew that Paul was responsible for the entries having been made. (Tr. 206, 236)

Lambert claims he did not receive any debit memos to support the two debits on his bank statement (Tr. 204), but there was other evidence that he must have received them. The testimony of Howard Wagner, admitted by stipulation, was that debit memos were always prepared in duplicate and one copy would be immediately mailed to the customer. The second copy was sent to the Continental Bank, which prepared the monthly checking account statements for State Bank of Clearing cus-

tomers. The Continental Bank had to have a check or debit memo in order to post any debit on the statement. (Tr. 323-4) Howard Wagner also testified that at the end of each month the Continental Bank sent the statements to the State Bank of Clearing where employees under his direct supervision verified that each debit on a customer's statement was supported by a check or debit memo and then mailed the statement, checks and the duplicate debit memos to the customer. (Tr. 323-324) Lambert himself admitted that the bank's practice was to mail one copy of the debit memo to the customer and enclose the other copy in the statement. (Tr. 204-205) There is, accordingly, highly credible evidence that Lambert *did* receive the debit memos which clearly stated that the two debits were not to correct any clerical errors but were to pay off certain Ringbloom loans and to transfer $250,000 in cash to Western. (PX 36)

Even if it is assumed that Lambert did not get either copy of the two debit memos, he knew that he should have received the debit memos in the mail and duplicate copies with his statement. (Tr. 204-5) He knew they existed and that he could easily obtain them from the Bank if he asked. (Tr. 207) The large dollar amount of the entries, the missing debit memos and Paul's evasive response by themselves should have prompted further inquiry by Lambert. Moreover, after looking at his bank statement (PX 35) and talking with Paul in early August 1972, Lambert knew that $250,000 had been transferred from his account to someone on July 17, 1972, and he also knew that Braemoor had received $240,000 from Western around July 25, 1972. (Tr. 122-3, 185, 201) The simplest inquiry by Lambert at the bank would have revealed that Paul had filled in the note which Lambert had signed in blank a few months earlier, that Paul had used that note to obtain a $417,567 loan from the bank, that Paul had transferred $250,000 of the loan proceeds to Western, and that Western had used $240,000 of those funds to pay Braemoor. Lambert would thus

have quickly and easily discovered the relationship between the entries on his bank statement and the payment to Braemoor, if he didn't already suspect such a relationship existed because of the past pattern of indirect financing by Paul. There is no excuse for Lambert's failure to make the very obvious, simple and easy inquiry which would have revealed the facts concerning the transaction.

Lambert attempted to excuse his failure to inquire at the bank about the $417,567.71 credit and the two debits by saying that he considered it to be "a private matter". (Tr. 207) But Lambert undercut his own explanation when he admitted that he mentioned the matter to Bennett and told Bennett that he was "shocked by the entry". (Tr. 238) Lambert then decided that he told Bennett that the money had been withdrawn from his account by two debit memos. (Tr. 239) Bennett, however, recalled that Lambert claimed he did not have the debit memos (Tr. 266), a statement which indicates that Lambert and Bennett must have discussed the entries on his bank statement in some detail. Perhaps realizing the contradiction between his excuse of privacy and his discussion with Bennett, Lambert tried to characterize his comments to Bennett as "a joking remark" and made "in a joking way". (Tr. 239) Bennett, however, did not characterize Lambert's comments as a joke, but rather recalled that Lambert "was really wondering what it was all about". (Tr. 265) Lambert's attitude was not that of someone who was trying to make a joke out of a mysterious $417,000.

When Paul refused to give an understandable explanation of where the $250,000 had gone, Lambert realized that he was not supposed to ask questions and deliberately chose not to ask for copies of the debit memos (which he knew existed and which were available on microfilm, as evidenced by PX 36). Under the circumstances, Lambert's minimal inquiry of Paul did not satisfy his duty of diligent inquiry; Paul's evasive response

itself should have prompted further inquiry by Lambert. Lambert's decision not to inquire was not prompted by any alleged feelings of "privacy", but rather by a desire to avoid having others at the Bank discover Paul's interest in Braemoor Associates, the history of his breaches of trust, the complicity of the Braemoor partners in those breaches and the fact that Braemoor had been the real beneficiary of the two loan transactions.

In view of all the extraordinary circumstances as set forth above and the law set forth in the *Higgins* case, supra, and other cases cited in plaintiff's Pre-Trial Brief, we submit that the defendants are charged with constructive knowledge of Paul's breach of fiduciary duties and are liable as constructive trustees for the full $300,000.